

No. 11506

United States
Circuit Court of Appeals
For the Ninth Circuit.

VICTORIA L. COTTON,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Transcript of Record

In Three Volumes

VOLUME II

Pages 397 to 785

Upon Petitions to Review a Decision of the Tax Court
of the United States

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(Testimony of Adolph K. Eitner.)

Q. What does it establish?

A. It establishes a transaction price at which the [438] stock traded.

Q. So you subscribe to Mr. McCune's views that the fair market value and the fair market price are two different things?

A. Well, no, I think we have to go a little further than that. I believe, for example, that a series of transactions in any security on the stock exchange represents fair market value, and the price is synonymous there.

Q. I don't believe that answers my question.

A. Well, it does not. Let us hear the question again.

Mr. Melville: Read it.

(Question read.)

The Witness: Let us go back to your original question and the \$1,000.00 a share on June 5, 1941.

By Mr. Melville:

Q. Could I have an answer to the last one first?

A. No, I would rather hear the—I will say, no, I do not subscribe to his views that there is a difference between price and value, assuming that your transaction which sets the price has all the circumstances that you outlined.

Q. What is your definition of market price?

A. You can have a market price——

Q. Can't you define market price? You use it.

A. If you will bear with me a minute here, you

(Testimony of Adolph K. Eitner.)

can have a market price which is not a fair market value. In [439] other words, you can have duress which establishes a price. Now, if you have all the factors in the transaction which——

Q. You may have misunderstood my question. I did not ask you to differentiate between fair market value and market price. I simply asked you to define market price.

A. Market price is the price at which the transaction takes place.

Q. All right. What, then, is your definition of fair market value?

A. My definition of fair market value would be the price at which a transaction, a purchase and sale, can be made between a willing and informed buyer and a willing informed seller without compulsion on either side.

Q. So your definition of the two are different by they boil down to the same thing, don't they?

A. No, because your transaction does not necessarily always involve a willing buyer and seller. You have transactions that result from duress or pressure.

Q. All right, let us talk about the transactions over the New York Stock Exchange today. Do they establish the fair market value of the stocks traded in?

A. I think they do, yes.

Q. Do they establish the market price of those stocks?

A. Yes, they do.

Q. Then is it your testimony that in all cases where there is not duress or a forced sale or some

(Testimony of Adolph K. Eitner.)

very unusual [440] extenuating circumstance, fair market value and market price are the same thing?

A. Yes, I would say that is the case, excluding extenuating circumstances.

Q. All right. If in 1941, and we will assume on June 5, 1941, a willing buyer under no compulsion to buy and not being under any pressure of any kind and a willing seller that owned some of this stock bought and sold at \$1,000.00 a share and the amount of the transaction was 100 shares or 200 shares, what would that establish, the fair market value or the market price, in your opinion?

A. I think a hypothetical case like that would probably establish the fair market value.

Q. Fair market value?

A. Yes, on a hypothetical basis.

Q. A hypothetical case? Now, if before this trial is over the government should introduce testimony that there were actual sales of this stock in 1941 at \$1,000.00 a share, would that establish a fair market value at \$1,000.00 a share?

A. I would have to know the circumstance of the sale.

Q. No compulsion to sell, a willing buyer, and a willing seller, the same circumstances as those we have gone over.

A. Well, I must still say I would have to have more detail as to what the circumstances surrounding the [441] transaction were before I could answer.

Q. If a hypothetical situation that we went over a few moments ago——

A. Yes.

(Testimony of Adolph K. Eitner.)

Q. —brought you to the frame of mind where you would feel that that hypothetical situation would establish the fair market price, why wouldn't the actual situation establish it?

A. Well, I suppose the answer is, yes, that it would establish it, but I still say that I would—before I would answer it for myself I would want to see some of the circumstances about it.

The Court: We will suspend at this time until 10:30 tomorrow morning.

(Whereupon, at 5:05 p.m., a recess was taken until 10:30 a.m., Thursday, October 11, 1945.)

PROCEEDINGS

October 11, 1945, 10:50 a.m.

The Clerk: Docket No. 2257, Victoria L. Cotton, and 7583, Virginia Caldwell.

ADOLPH K. EITNER,
resumed his testimony as follows:

Cross Examination (resumed)

By Mr. Melville:

Q. Mr. Eitner, as I understand, yesterday you testified that the stipulated royalty income of roughly \$9,000,000.00 plus was valued at 6 per cent compound interest discount to give \$5,868,000.00, is that correct?

A. That is correct, yes sir. I assume your figures are correct. (After examining) That is correct.

(Testimony of Adolph K. Eitner.)

Q. Then you deducted, I believe, 15 per cent for taxes? A. Yes, sir.

Q. And that amounted to \$880,200.00?

A. 300 I have here in my notes.

Q. The balance of the fair market value of the royalties, then, as an asset to the company, amounted to how much?

A. I did not testify that I considered that the fair market value of the royalty. The residual figure was \$4,988,000, roughly \$5,000,000.00.

Q. The value per share of the trust, then, was \$475.00? A. Yes, sir.

Q. That value of \$4,988,000.00, approximately, and all [447] stipulated fair market values of assets were then discounted further, each at an individual rate, to obtain the values of the share of each asset to the stockholder? A. Yes, sir.

Q. The total net asset value, then, to the company was \$950.00 before any discounts to determine the value of the same corporate assets to a stockholder? A. That is correct.

Q. That is what it would cost the company, then, to replace the assets in kind?

A. I don't believe I can testify as to what it would cost the company to replace the assets in kind.

Q. You have just testified that that is the fair market value of the assets. If something has a fair market value, why couldn't it be replaced in kind at that figure?

(Testimony of Adolph K. Eitner.)

A. I did not testify as to the fair market value of the royalty.

Q. All right. The asset value of the royalty added into the balance sheet is \$475.00 per share, isn't it?

A. Maybe we could define that figure of \$475.00 in the manner in which it was computed, which is taking the——

Q. Is it or is it not \$475.00?

A. \$475.00 is correct.

Q. All right.

Mr. Mackay: He has a right to explain his answer. [448]

Mr. Melville: I think it will be explained, Mr. Mackay, If I am permitted to proceed with my questions.

The Court: Proceed.

By Mr. Melville:

Q. Do you agree, then, that the total net asset value to the Dominguez Estate Company was \$950.00 before any discounts to determine the value of the same group of assets to the stockholders?

A. Yes, those are the asset values that I have computed.

Q. And that is based upon the stipulated fair market values of everything except oil royalties?

A. Correct.

Q. Would you say, then, that the figure of

(Testimony of Adolph K. Eitner.)

\$950.00 represents what it would cost the company to replace those assets in kind?

A. No, sir, I would not.

Q. Would you explain?

A. I have no way of knowing or having an opinion as to what it would cost them to replace the oil royalties. I would agree on the other items that your statement is correct.

Q. Could they replace an oil royalty such as they have here with one just like it at any price?

A. I could not speak on that subject.

Q. Then does the figure of \$950.00 represent the value of the only asset you know about through the stipulation and [449] through your knowledge?

A. I am sorry, I didn't get the—does that represent the fair market value——

Q. No, the value.

A. By value, I assume fair market value.

Q. Go ahead. You assume it.

A. I think I should answer the question—in answering the question, I will agree on everything but the oil royalty. The oil royalty is a reduction at present values of the expected future income based on the projection which is entered as an exhibit.

Q. Now, as I understand it, Mr. Eitner, in dealing with ranch real estate you took the figure which was stipulated as the fair market value of the ranch real estate and applied a discount of 75 per cent?

A. In appraising the value which it represents in the stock.

(Testimony of Adolph K. Eitner.)

Q. That is right. A. Yes, sir.

Q. But you do not dispute the fact that the fair market value of the royalty was as stipulated?

A. Not in the least.

Q. Although you do apply a discount factor of 75 per cent?

A. In bringing it through to the stock, that is correct. [450]

Q. Now, on oil royalties you apply, instead of a 75 per cent factor as you did in real estate, a 45 per cent factor? A. That is correct.

Q. And arrive at a figure of \$261.00?

A. Yes, sir.

Q. Why, then, aren't you willing to let us fill in the figure of \$475.00 in the asset column following your other figures of \$55.00 for net current assets, \$109.00 for stocks and bonds, \$155.00 for ranch real estate, and \$156.00 for other real estate? If we do the same thing now as to oil royalties, carrying back your \$261.00 figure with a 45 per cent factor, we would arrive at a figure of \$475.00? Isn't that a fair presentation of your testimony yesterday?

A. It is a fair presentation with this qualification, I believe, that you must explain the \$475.00 figure as to how it is arrived at, and should not confuse it with the thought that I have any knowledge of what the market value of that royalty was as of the basic date, because I have no such knowledge.

Q. Did you use as a basis for your testimony yesterday the figure of \$475.00 as being the asset value

(Testimony of Adolph K. Eitner.)

back of the Dominguez Estate Company stock as represented by the oil royalties?

A. Yes, as a capitalization of the expected income.

Q. The same as you used \$156.00 for other real estate? [451]

A. No, that represents the fair market value of other real estate, and I do not say that the \$475.00 figure represents the fair market value of the royalty.

Q. Reconstructing your testimony with respect to Carson Estate Company stock; I believe the stipulation shows, and you took it into consideration in your testimony, that the Carson Estate Company owns directly 1,785 shares of Francis Land Company stock? A. Yes, sir.

Q. And in view of the fact that each share of Francis Land Company stock has back of it approximately 1.1 shares of Dominguez Estate Company stock, then isn't it true that the Carson Estate Company owns through its Francis stock the equivalent of 1,963 shares of Dominguez stock?

A. Yes. I have not computed—I haven't my figures on that here, but I assume that is correct.

Q. In order that you might follow my line of questioning, I would be glad to give you a copy of the way we have tried to reconstruct your testimony (handing). A. Thank you.

Mr. Melville: It is not in evidence, your Honor.
By Mr. Melville:

Q. If you would like to make that computation

(Testimony of Adolph K. Eitner.)

of 1.1, approximately, times 1,785, I think you will arrive at 1,963.

A. That is correct, yes. [452]

Q. Now, then, the number of Dominguez shares directly owned were 1,353? A. Yes, sir.

Q. Therefore, the number of shares of Dominguez directly or indirectly owned would be 3,316?

A. Yes, sir.

Q. The shares of Carson outstanding were 7,412?

A. Correct.

Q. The shares of Dominguez in relation to shares of Carson gives us a factor of .4475?

A. Correct.

Q. Now, you had a value of \$509.00 for Dominguez stock as carried into Carson, didn't you?

A. Yes, sir.

Q. Now, apply the factor of .4475; you get \$228.00 to the Carson Estate Company, wouldn't you?

A. That is correct.

Q. Then you take a 5 per cent discount and get \$217.00? A. Correct.

Q. Now, would you go on from there and explain the rest of this schedule and fill in any blanks that might appear?

A. Could I borrow a pencil for a moment?

Q. Yes, sir.

A. I left mine at the office, unfortunately.

(A pencil was handed to the witness.) [453]

A. (Continuing) (After making computation). Oil properties brought down to a present worth basis

(Testimony of Adolph K. Eitner.)

in the same manner as in the case of Dominguez brings them down to \$356,501.00, which is \$48.00 a share. We applied the same discount factor to get a total as represented in the value of the stock of \$27.00 a share. Net current assets were a total of \$167,778.00, which brings you out at \$22.00 a share and we carry that over at \$22.00 a share. Ranch real estate at \$446,000.00, or \$60.00 a share, carries over with the 75 per cent discount to \$15.00 a share. Other real estate, \$147,000.00, with a 75 per cent discount in this case, gives a gross figure of \$20.00, and a net figure of \$5.00. You have a 50 per cent in here, Mr. Melville.

Q. Yes. Is that wrong?

A. That should be 75 per cent. That brings you out to \$5.00 a share.

Q. Just at that point, let me ask you, Mr. Eitner, yesterday when you discounted in the case of Dominguez Company the ranch real estate at 75 per cent, it was my understanding of your testimony that you discounted other real estate at 50 per cent.

A. I did in the case of Dominguez.

Q. Will you explain why you did not do that in Carson?

A. I did not do that in Carson because the Carson real estate for 1939 and 1940 and in the immediately preceding [454] years had been non-productive so far as net income was concerned. It was not producing any earnings.

Q. Go on.

A. That bring you out to \$5.00 a share. Your

(Testimony of Adolph K. Eitner.)

stocks and bonds are blank, I believe, in the case of Carson. Is that correct?

Q. Yes, I believe so.

A. So that is eliminated. We run a total here of \$286.00, which we discount by 20 per cent, which is \$56.00, arriving at the final figure of \$230.00.

Mr. Melville: No more questions.

Mr. Mackay: That is all. Thank you.

(Witness excused.)

Mr. Mackay: If your Honor please, Petitioner at this time has no more witnesses. There is one thing I would like to clear up, though, and we have not quite got it ready. In one of our exhibits we show the stockholders of each one of the companies and their names, and what I should like to do is to get a list showing the relationship of the Petitioner to these other stockholders. I am not prepared to do that right now.

Mr. Melville: No objection.

Mr. Mackay: We will get that and put it in later.

The Court: Are you ready to proceed with the testimony for the Government? [455]

Mr. Melville: I did not understand that the Petitioner had rested.

Mr. Mackay: Yes.

The Court: I understand he is resting with the understanding that he wants to put in one additional stipulation or Petitioner's exhibit. Is that correct, Mr. Mackay?

Mr. Mackay: Yes, your Honor.

The Court: You may proceed.

Mr. Melville: Call Roger White.

EVIDENCE ON BEHALF OF RESPONDENTS

Thereupon, the Respondent, to maintain the averments on his own behalf, introduced the following proof:

ROGER F. WHITE,

called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: Your name, please, sir.

The Witness: Roger F. White.

By Mr. Melville:

Q. Mr. White, what does your formal education consist of?

A. I graduated from high school in the State of Colorado and received the degree of Engineer of Mines at the Colorado [456] School of Mines in 1918.

Q. At the Colorado School of Mines did you take various courses in mathematics?

A. Yes, sir.

Q. What courses?

A. Well, practically all of them up through calculus, trigonometry, analytical geometry, and so forth, up through calculus.

Q. Do you know how to operate a calculating machine?

A. Yes, sir.

(Testimony of Roger F. White.)

Q. Have you confidence in the results?

A. Yes, sir.

Q. Were you present during the testimony of Mr. Paine? A. Yes.

Q. You listened to the various yardsticks that he used in reaching his valuations? A. Yes.

Q. Were you present in court when the government and the Petitioner reached a stipulation as to the fair market value of the oil royalties in the Carson Estate Company? A. Yes.

Q. And do you recall what that figure was?

A. Yes.

Q. What was it? A. \$285,000.00. [457]

Q. Now, by reason of your mathematical training, can you convert that \$285,000.00 back into the yardsticks and then apply those yardsticks to the matter which is still in question in the Dominguez Estate Company case? A. Yes.

Q. Have you done so? A. Yes, sir.

Q. Would you please explain to the Court the results of your calculations?

Mr. Mackay: If your Honor please, I object to that as being entirely irrelevant, immaterial, and incompetent. This Court has the record here, and from the evidence the Court is the one to pass upon the weight of the testimony. The Court is the one who makes its conclusions from all the evidence. It seems to me to be entirely incompetent for this witness here, who has run an adding machine and who relies upon the adding machine as being correct—which I might say that I do if you get the

(Testimony of Roger F. White.)

right figures—but that does not make him an expert on valuation. If your Honor please, there are a lot of things to weigh in this particular case. The witnesses have time and time again testified as to the particular factors going into each particular lease, each particular property, and a lot of those other things. Now, what counsel is trying to do is to superimpose upon your Honor a mathematical computation to try to prove a value. So, if your Honor please, I may [458] say this, that those mathematical computations can be made as well in the brief as before your Honor. I know one thing, they are not proper before a court, and I object to them.

Mr. Melville: Your Honor, we are not trying to impose on the Court any opinion of this witness as to the fair market value of oil royalties in the Dominguez Estate Company case. We are simply trying to assist the Court by doing for the Court the mathematical computations which the Court might want to do himself. If the Court, after hearing the computations, thinks they are of no weight or importance, the Court has the discretion, of course, to disregard them. I have not asked the witness for an opinion. I have simply asked him to do a mathematical computation which I as a lawyer do not know how to do.

Mr. Mackay: If your Honor please, if permitted, I would like to and would probably have to follow up with a very good accountant who has computed the values, taking into consideration the actual taxes, and we could spend several weeks here

(Testimony of Roger F. White.)

showing that the same computations my friend is making would be no values. I think it has no place, if your Honor please, in a proceeding before this Court to do that.

Mr. Melville: Your Honor, while Mr. Paine was on the witness stand there was a little conversation back and forth among us in a very jovial mood, during which the witness, Mr. Paine, made some disparaging remarks about our profession, [459] and the Judge remarked that he would be very happy if the engineers would give him a yardstick which was fairly accurate. Now, we have in this case two oil properties to value at exactly the same date, June 5, 1941. Both parties have agreed upon the fair market value of one oil royalty as of that date. It seems to me that your Honor might well consider how that, worked back through a yardstick, would bring out the answer to the one remaining question as to the underlying assets in the Dominguez Estate Company case. I think it is entirely proper for the Government to furnish this Court with such a calculation.

Mr. Mackay: If your Honor please, I would like to be heard on that. It seems to me it is absurd. Your Honor will recall the testimony with respect to the various leases, and the oil royalties in the Carson Company were very minor, conditions were different, and the witnesses have so testified. Now, if your Honor please, we have not got all the evidence in here. I propose, and I think I have that right, and I propose, depending upon what counsel

(Testimony of Roger F. White.)

put in the record, to put on evidence in rebuttal. Are we going to stop every 15 minutes when a witness gets off the stand and say, "We have got a yardstick and that will settle the case"? That is where we are going if you let this witness testify along that line. I submit, if your Honor please, that it is entirely improper. The evidence is not in yet. We would have a right to make our [460] computations. We have accountants and we have engineers, and I may say they can run comptometers and adding machines as well as Mr. White. I don't think it is a proper thing, and if he goes on with that we want to analyze what is going on. Until the evidence is in and the Court can see all the evidence, I think it is improper. We can submit any computations we want to in the brief.

The Court: I am not sure I understand exactly what sort of a computation you are proposing to offer, Mr. Melville. You have agreed here upon the value of certain oil properties owned by the Carson Estate as being \$285,000.00.

Mr. Melville: That is right, your Honor.

The Court: Now, from there where is it you propose to go and what is it you propose to do by this mathematical calculation?

Mr. Melville: Simply this, your Honor, that we have two things where there are oil royalties or barrels of water or tanks of turpentine, or anything else, and we want to know how much is in this tank and we have no yardstick, but we do know how much there is in this other tank. We can

(Testimony of Roger F. White.)

take a long pole or a stick and put it down in there and see how far up the water or the turpentine comes, and then if we put it down in the other tank and find out it only comes half-way up, doesn't it follow, your Honor, that there is only half as much turpentine in the one tank as there is in the other, and yet we did [461] not have a yardstick to do it with.

The Court: Well, I understood that these oil royalties in the Carson Estate were recognized as being comparatively insignificant, and that you were not going to take any time to prove the value of them.

Mr. Mackay: That is the only purpose for which we did it, your Honor.

The Court: The purpose of your admission——

Mr. Mackay: That is the only purpose and it was for no other purpose.

Mr. Melville: Your Honor, the witnesses that have been on the stand so far, and they have all been petitioner's witnesses, have all informed the court that the Reyes lease is by far the best of them all, and the Reyes lease is on the Dominguez field which is a better field than the Carson field. Therefore, if our calculations show a certain figure for Dominguez Estate, it is conservative because it is applying the same yardstick that we have established by using the inferior field to the better field.

Mr. Mackay: If your Honor please, may I be heard just a moment on just how Carson was such an insignificant amount? It was solely to conserve

(Testimony of Roger F. White.)

the time of the Court in argument. We stipulated a value, at which time I assumed that that would be taken and your Honor put that in with consent [462] of both counsel into the balance sheet along with other values of assets. Now, if they are going to use this oil royalty which is stipulated to at \$285,000.00 for any other purpose than they would use our stipulated fair market values of other assets—and I refer to real estate, I refer to \$7,000,000.00 of stocks and bonds which we did not discount at all under the blockage rule, we took merely the quoted prices to arrive at a value, and if that were taken and reflected in the stock it would make quite a few dollars difference—now, if this is permitted and they are to make something out of that stipulated value and if they are going into the question of how we arrived at the stipulated value, we want the same privilege, and we offer to show and we will show it is worth a whole lot less than that stipulated value because it could not have been sold for that at that time.

Mr. Melville: Up to this time we have not gone back of the stipulated figure of \$285,000.00, but the record will show that the plaintiff put on two witnesses to testify as to the value of the oil royalties in the Carson Estate Company. The first witness, as I recall, testified to a value of \$174,000.00, and the second witness to a value of \$283,000.00, and it was very quickly thereafter that petitioner and respondent agreed upon a fair market value of \$285,000.00, which is substantially the figure that

(Testimony of Roger F. White.)

petitioner's own witness testified to. That is the reason that that figure was stipulated [463] to, because the government felt that there was no need to call a number of witnesses and burden this court with testimony as to the fair market value of the oil royalties in the Carson Estate Company in view of the fact that petitioner's own witness testified substantially to what the respondent's witness would testify to. Having stipulated it, it seems to me that we have positively established the fair market value for the purposes of this case on the oil royalties in the Carson Estate Company case, and it is not out of place, it seems to me, to do the mathematical calculations which, if the Judge would want them done after the case is submitted, we are simply doing them now to save his Honor any inconvenience in having them done later.

Mr. Mackay: If your Honor please, it would seem to me that a mathematical computation as a part of the evidence then would be a nullity. Is it possible we are going to get—the rebuttal evidence in this case may change the basis of his mathematical computation. The trouble with the government, if your Honor please, is that they are trying to adopt a yardstick, that is what they want to try to do, but yet they are comparing apples with peanuts, or something else. Your Honor will recall there was considerable difference between the two properties, not only with respect to the prices of the oil, but other factors. It seems to me we are taking up too much time and wasting time. [464]

(Testimony of Roger F. White.)

The Court: I am disposed to let the evidence in, although I think its materiality is quite doubtful. I think I understand what he is trying to do. I will overrule the objection and he may testify.

Mr. Mackay: Note an exception.

The Witness: There was a stipulated value of \$285,000.00 as the fair market value of the royalty interests of the Carson Estate Company. There was also a stipulation that the future expected income from these royalties was \$476,542.00.

Mr. Mackay: What is that number?

The Witness: \$476,542.00. There was also an estimate of oil reserves for these properties of 398,796 barrels, which would result in an average price of oil of \$1.19495 for the estimated oil reserves.

Mr. Mackay: May I ask counsel if this is based upon the estimate of oil reserves for Carson? If they are not going to accept the stipulation as the fair market value, I rise now to withdraw the stipulation.

The Court: I think I understand what they have done here. He is showing that while some evidence indicates that the value of \$9,000,000.00 was some \$3,000,000.00 above the yards'isk used, in valuing the oil in the ground, that in pumping it out and so on, that amounted to some 40 cents a barrel and he is showing here that your other calculation [465] amounted to \$1.94 per barrel. Is that about what it amounts to?

The Witness: No, it really amounts to a value

(Testimony of Roger F. White.)

of \$.7146 per barrel for the estimated oil reserves in the Carson Estate Company properties.

The Court: Does that complete your answer?

The Witness: No. I was trying to analyze these figures to see what the ratios were, and, in summary, the Carson Estate Company's ratio of value to expected future income was 59.8058 per cent. In other words, he valued an expected income of \$476,000.00 at \$285,000.00, which is about 59 per cent. Applying the same ratio to the estimated future income from the Dominguez Estate properties, we would arrive at a value of \$5,400,451.00 as the value of the Dominguez Estate Company properties, giving effect to the difference in the average price of oil.

By Mr. Melville:

Q. Now, is that what you would call the percentage of ultimate basis of valuing of oil royalties?

A. Yes.

Q. Did you apply a yardstick now to another method of valuing oil royalties?

A. Yes. The ratio of prices between the Carson Estate Company properties and the Dominguez Estate was .945437. In other words, the average expected price of oil from Dominguez [466] Estate properties was slightly less than that which was anticipated from the Carson Estate Company properties, and applying that factor of 94.54 per cent to the Dominguez Estate Company properties, we would find that the value of the oil in the ground, or the unit value, was 67.5656 cents per barrel as

(Testimony of Roger F. White.)

compared to the 71.465 cents in the Carson Estate valuation. That was all.

Q. Is that latter comparison on the basis of the value per barrel of oil in the ground?

A. That is right.

Mr. Melville: Your witness.

Cross-Examination

By Mr. Mackay:

Q. How much per daily barrel does that figure for the Carson?

A. I don't know. I don't have the barrels per day production on the property.

Q. It is 200, isn't it?

A. Just about 200, I think so.

Q. Did you give any consideration to the average daily production? A. No.

Q. Or the price per barrel? A. I did not.

Q. Why didn't you do that if you were trying to make [467] the yardstick that would help the Court?

A. I am not trying to establish a yardstick. I am just trying to show the basis that would exist on this basis of valuation.

Q. Can you tell if the Carson royalty is equivalent to—withdraw that.

Mr. Paine testified that the Carson royalty was equivalent to 14 per daily barrel—1,400. Now on that same basis, applying that yardstick, what would the Dominguez royalty on a comparable basis be worth?

(Testimony of Roger F. White.)

A. I don't know. I have not made that calculation.

Q. Well, can you do it?

A. Well, I probably could yes. I would have to have——

The Court: I don't understand this witness is offered as a valuation expert but merely as one to work out a mathematical problem.

Mr. Melville: I believe that is correct, your Honor. All I have attempted to qualify him for is as a person who knows how to add, subtract, multiply, and divide. He has done it and he has put in his testimony. When they go beyond that they are going beyond the scope of the direct examination.

Mr. Mackay: I think not, your Honor.

The Court: I think if you have another problem you want him to work out which ties in with some other figures, you may do so. [468]

Mr. Mackay: I certainly have a right to ask him what he took into consideration and why he did not take other things.

Mr. Melville: If counsel wants him to work other calculations, I think he ought to furnish him with a calculating machine.

The Court: Counsel may proceed with the cross-examination of this witness.

By Mr. Mackay:

Q. Now, Mr. White, if the average daily production of Carson was 200 barrels a day, daily

(Testimony of Roger F. White.)

average production 200 barrels, and if it had a fair market value on that date of \$285,000.00, what would you say would be the equivalent per barrel?

A. 200 barrels a day divided into the \$285,000.00.

Q. That would give you 1,400? Would you or can you divide, I mean, without a comptometer?

A. Unfortunately, I have used a comptometer so long I am practically helpless without one. (After making computation.) Yes, that is right, the value would be about \$1,475 per barrel.

Q. Can't you check your figures? Doesn't it come out around \$1,400.00?

A. \$1,425.00 per barrel.

Q. \$1,425.00? [469] A. Yes.

Q. Now, if you applied that same ratio of \$1,400.00 per barrel, or \$1,425.00, to the average daily production from the Dominguez, what figure do you get?

A. I don't know what the daily production of Dominguez was.

Q. 1,500 barrels. Let us assume it was 1,500 barrels. A. Assuming it is 1,500 barrels?

Q. Yes.

A. I don't know whether that was the production of that lease.

Q. Let us assume that the average daily production was 1,500 barrels.

A. 1,500 barrels, and you want to multiply it by \$1,425.00?

Q. Yes.

(Testimony of Roger F. White.)

A. That appears to be \$2,137,500.00.

Q. Yes. A. Quite so.

Q. So, then, if you make a comparison there as between the two on the average daily production, you get a fair market value of Dominguez?

A. I didn't make that comparison.

Q. Wait a minute. I am asking you. Please wait. A. All right. [470]

Q. If you make the same comparison as to the average daily production, then you arrive at a fair market value of the Reyes lease of \$2,137,000.00, that is right, isn't it? A. That is right.

Mr. Mackay: That is all.

Mr. Melville: Just a moment, please.

Mr. Mackay: Just a moment. I have one more question.

By Mr. Mackay:

Q. Mr. White, doesn't this show you that this sort of study can be awfully inconsistent?

A. Well, I have been at this business for about 25 years, and I quite agree with you. I don't agree with your barrels per day method where you have different properties.

Mr. Mackay: That is all.

Redirect Examination

By Mr. Melville:

Q. I would like to have you explain that last. You are familiar with the daily production per day, that is, the production per day method of valuing, are you? A. Yes, sir.

(Testimony of Roger F. White.)

Q. Does that apply fairly to oil properties which are under curtailment? A. I don't—

Mr. Mackay: If your Honor please, I object to that. [471] The witness is not qualified to answer. Is he being put on here as an expert witness on valuations?

Mr. Melville: No, but you asked him a question which would seem to indicate you recognized his ability.

Mr. Mackay: No, I did not. I merely—

The Court: I will sustain the objection to the present question. Off the record.

(Discussion off the record.)

Mr. Melville: No more questions.

(Witness excused.)

Mr. Melville: Mr. Evans.

LOUIS H. EVANS,

called as a witness for and on behalf of the respondent, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: Your name, please?

The Witness: Louis H. Evans.

By Mr. Melville:

Q. Will you state your qualifications, Mr. Evans?

A. You mean my education, training, and experience?

(Testimony of Louis H. Evans.)

Q. That is right.

A. I wonder if I might submit a certificate which I usually place in my valuation reports in private practice which [472] outlines them?

Mr. Melville: I have given counsel a copy of his qualifications.

The Court: We will suspend for a brief recess.

(A short recess.)

By Mr. Melville:

Q. Will you state your qualifications?

A. I was educated at Granville, New York, High School; Cornell University, 1908; eight years in Philippine Insular Service. 1918-1919, First Lieutenant, Engineers, United States Army. 1919-1921, Chief Engineer, Magnolia Oil Company in Mexico (Cia De Inversiones "Aztlan" S.A.). 1921-1922, Valuation Engineer, Oil and Gas Division, Income Tax Unit, Washington, D. C., California and Mexican properties. 1923 to 1938, private practice in Los Angeles.

As appraisal engineer with the Treasury Department I established the oil reserves and values on all of the properties of the Standard Oil Company of California, Union Oil Company, General Petroleum Corporation, C. C. M. O., Associated Oil Company, Honolulu Oil Company, and many others.

I am affiliated with the American Association of Petroleum Geologists and the American Society of Civil Engineers.

There follows a partial list of clients for whom

(Testimony of Louis H. Evans.)

I have done work from 1923 to 1938: California Petroleum Corporation, General Petroleum Corporation, Dabney Oil Syndicate, [473] San Francisco McKittrick Oil Company, California Star Oil Company, Trojan Oil Company, Graham Loftus Oil Company, Oil Royalties, Southern California Edison Company, Wilshire Oil Company, Childs Estate, Dominguez Estate, I. W. Hellman Estate, Gardena Syndicate, Carson Estate, California Cooperative Corporation, Big Ten Oil Company, Surprise Oil Company, B. B. & O. Oil Company, Midway Pacific, Hunt, Weatherwax & Blyth, Marine Oil Company, California Eastern Oil Company, Charles Sumner Young Estate, Caribou Oil Mining Company, Argonaut Oil Company, Visalia Midway Oil Company, Producers Oil Company, Schaff Noble Oil Syndicate, Palmer Union Oil Company, National Pacific Oil Company, Midway Gas Company, Los Angeles Gas and Electric Company, Dominion Oil Company, Signal Royalties, Ventura Fuel Company, E. S. Barnard Company, Baker-Grover Oil Company, Bolsa Chica Oil Corporation, Delaney Producing & Refining Company, Pacific Western Oil Company, Group One Oil Corporation.

For personal details see *Who's Who in Engineering*, 1931-1933 and 1937.

Q. Since 1938, Mr. Evans, what has your occupation been?

A. Since 1939 I have been senior petroleum appraisal engineer for the Division of Assessment Standards, California State Board of Equalization.

(Testimony of Louis H. Evans.)

Q. Mr. Evans, were you ever called upon by the Dominguez Estate Company to make an appraisal of certain of their leases? [474]

A. Several times.

Q. Did you make such an appraisal in 1938?

A. I did, June 30, 1938.

Q. I might ask you at this time, have you received a subpoena in this case? A. I have.

Q. And are you appearing here under subpoena?

A. I am.

Q. I hand you a book and ask you if you recognize it. A. (After examining.) I do.

Q. What is it?

A. A copy of the appraisal report I prepared for the Dominguez Estate Company as of June 30, 1938.

Q. Is it a true copy?

Mr. Mackay: I will stipulate it is a true copy.

Mr. Melville: Very well.

By Mr. Melville:

Q. For what purpose did you make the appraisal in 1938?

A. It was explained to me at that time—I had made a number of previous reports for the company—that a number of the younger members of the Dominguez family were coming in to take an active interest in the affairs of the company and that a report was desired that should describe the oil properties of the company in some detail, giving the past production, well records, past royalties, and

(Testimony of Louis H. Evans.)

it was desired that a valuation [475] be placed upon the property. That is all I know of the purpose for which that report was desired.

Q. Do you know whether or not your appraisal was made for estate tax purposes?

A. I do not know, sir.

Q. Do you know that it was not?

A. I do not. I know nothing more about the purpose of that report than I have stated.

Q. Just for your protection, Mr. Evans, and for the purpose of the record, I would like to have it show that the copy which you identified was obtained from the petitioner and not from your files.

Mr. Mackay: The record may show that Mr. Mackay at the request of Mr. Melville handed Mr. Melville this copy.

By Mr. Melville:

Q. Mr. Evans, do you recognize that an appraisal in 1938 would not be controlling in 1941?

A. Certainly, I recognize that.

Q. Would it have some indication as to the accuracy of appraisals made in 1941?

A. I did not understand the question.

Q. If a geologist or engineer made an appraisal in one year, and two or three years later made an appraisal of the same property, would he start afresh or would he go back to the previous appraisal and bring that up to date? [476]

A. He would be rather dumb if he did not start afresh.

(Testimony of Louis H. Evans.)

Q. Did you or did you not in 1938 appraise the following leases: Reyes——

Mr. Mackay: If your Honor please, I object to the leading question.

The Court: Overruled. He may answer that.

By Mr. Melville:

Q. Reyes, DeFrancis, Manuel, Richfield-Selbar, Continental, Marland, and Carpenter—did you appraise those leases for the Dominguez Estate Company? A. I did.

Q. Are those on the Dominguez oil fields?

A. They were in the Dominguez oil fields.

Q. In the Torrance-Redondo field did you or did you not appraise the Standard-Getty, G.P.-Carson, and C.C.M.O. leases? A. I did.

Q. Did you appraise any other leases at that time? A. I do not recall.

Q. I show you a copy of your appraisal report and ask you to examine that and refresh your memory.

A. (After examining): That is apparently all of the properties which I appraised.

Q. Can you state at this time what value you placed on the leases in the Dominguez Hill in 1938?

Mr. Mackay: If your Honor please, I object to that as incompetent, irrelevant, and immaterial, and as having no bearing upon the issue here. The witness has already testified that a value in 1938 would have no material bearing upon a value in 1941, which your Honor is very well familiar with,

(Testimony of Louis H. Evans.)

and I submit it is entirely incompetent, irrelevant, and immaterial.

The Court: Objection sustained.

By Mr. Melville:

Q. Mr. Evans, have you been furnished with the stipulated figures in this case as to oil reserves and estimated future income from the Dominguez Estate oil properties?

A. I have. The latter statement, as I recall, was estimated probable future income, which was stipulated.

Q. Were you asked to make an appraisal?

A. I was.

Q. Based upon the stipulated figures?

A. I was.

Q. Were you asked to make that appraisal for the purpose of arriving at your opinion of the fair market value at June 5, 1941, of the Dominguez Oil Royalties? A. I was.

Q. Did you arrive at an opinion?

A. I did. [478]

Q. What is it?

A. In my opinion the fair market value of the oil royalties of the Dominguez Estate Company in Dominguez Hill as of June 5, 1941, was \$4,000,000.00.

Q. How did you arrive at that opinion, Mr. Evans?

A. Well, to begin with, I examined the stipulated figures as to the probable future income to

(Testimony of Louis H. Evans.)

be derived from these royalties and decided that the use of the word "probable" indicated a possible element of error in these figures which had been stipulated to as to the future net income. This future net income had been based upon an estimate of reserves, the reserves of oil and the probable rate at which this oil would be produced. Now, to determine the possible element of error in the stipulated figures as to probable future income, it was necessary for the appraiser to consider the conditions obtaining on June 5, 1941.

At that time the oil industry here on the Coast had just begun to feel the impact of our war or defense program. The increase in industrial activity had a rather curious effect, first, in greatly increased demand for heavy crudes and apparently a lessened demand for gasoline and light oil, which was indicated by rapidly decreasing crude oil and fuel supplies and an increase in our light oil and gasoline storage.

California oil fields were being operated under curtailment. The Dominguez oil field, according to the California [479] Conservation Committee, had an effective potential maximum of 87,500 barrels a day, and was actually producing less than 27,000 barrels a day from that Dominguez oil field. There were about 50 to 55 flowing wells. Each had a top allotment and could not be produced in excess of 171 barrels per day. There were around 60 to 65 gas lift wells, producing about 90 barrels a day.

(Testimony of Louis H. Evans.)

The balance of the total of 302 wells were pumping wells.

Now, every petroleum engineer was aware by this time that any estimate of reserves made and based on the production of a field as severely curtailed as that is certainly suspect so far as reasonable accuracy to be obtained.

So, I discounted the tabulation furnished me on the stipulated future net income of the Dominguez royalties at a 10 per cent compound interest rate. The result of that computation was to reduce the total future expected royalties amounting to \$8,666,000.00, to the sum of \$5,003,000.00, and some odd.

I was informed that the price used in determining this stipulated probable future income was based upon the price existing on June 5, 1941. The estimate of future net earnings, then, discounted entirely the law of supply and demand and ignored entirely increasing evidence during those years of a tendency towards inflation.

Weighing all of these factors, it was my judgment and opinion that this present worth value of \$5,003,000.00, and [480] some odd should be reduced by about 20 per cent. Accordingly, \$4,000,000.00, in my opinion, was the fair market value of the royalties of the Dominguez Estate Company as of June 5, 1941.

Q. Now, Mr. Evans, if you assume that the stipulated figures are absolutely correct, what would

(Testimony of Louis H. Evans.)

your opinion be as to the fair market value of the Dominguez oil royalties on June 5, 1941?

A. Obviously, if I had the assurance that they were correct, the value would be \$5,000,000.00.

Mr. Melville: Your witness.

Cross-Examination

By Mr. Mackay:

Q. Mr. Evans, how long did you state you have been up at the Board of Equalization?

A. Since 1939.

Q. And the problem of an equalization board is what it means, to equalize taxes, isn't it?

A. Yes, sir, to attempt to.

Q. What? A. To attempt to.

Q. That is right. You are not concerned there with fair market value, are you?

A. Yes, indeed.

Q. But it is mostly to equalize the taxes? [481]

A. Every year I have to make a determination of the recoverable reserves of each and every oil and gas field in this state, place a fair market value on each oil field, and I then gather from the various assessors, the total assessment figures which they placed upon these fields, and report to the Board the relation between assessed values and fair market values.

Q. Now, Mr. Evans, have you been on this Dominguez property lately?

A. Not since 1941—not since 1939.

Q. Not since 1939? A. No.

(Testimony of Louis H. Evans.)

Q. You are not, then, familiar with its operations, and you were not familiar with its operations in 1939, 1940 and 1941, were you?

A. In what respect do you mean? I have to be familiar with the operations that are going on in every oil field in this state.

Q. Well, you have not checked each well down there, have you? A. Indeed I do.

Q. In Dominguez?

A. I take the Scout Service and get a card every week showing in detail the completion date and all the dope on every well that is completed in the field, and every field.

Q. Are you familiar with the terms of the Reyes lease? [482]

A. The terms of the Reyes lease? No, sir.

Q. You have never read them?

A. No, sir. I think you will find in that certificate a statement that I have not examined into and do not pass upon titles or any of the leases.

Q. Ordinarily, doesn't the terms of the lease have some bearing?

A. Certainly they do.

Q. Now, Mr. Evans, I think you stated that you took the estimated future production, future income, and you discounted that 10 per cent?

A. Yes, sir.

Q. And that brought you down to the present worth figure of something in excess of \$5,000,000.00. Am I stating it correcelty.

A. That is correct.

(Testimony of Louis H. Evans.)

Q. And then after you arrived at that, what factor did you take into consideration when you reduced that present worth to your figure of in excess of \$5,000,000.00?

A. I thought I had explained very, very clearly. I have taken into account the possibility of error in the estimation of reserves, the possibility of error in the price used, and in my opinion a further reduction of 20 per cent was warranted in arriving at that fair market value.

Q. How did you spread that 20 per cent, between what? [483]

A. How did I what?

Q. How did you arrive at that 20 per cent?

A. That was a mental process that I don't know that I can thoroughly explain. It is the result of some 20-odd years of experience in arriving at the value of properties.

Q. So you have used that same method for 20 years or more?

A. Yes, but I vary in the discount which I may make.

Q. What conditions would lead you to vary that?

A. Well, I think if you look that 1938 report over you will find that I was so confident that my estimate of reserves which I had made on the Reyes lease, and so forth, was a minimum that was going to be recovered, that I used no further discount whatsoever, but, on the contrary, on the other leases that I did apply varying factors which

(Testimony of Louis H. Evans.)

in my judgment and opinion would arrive at fair market value.

Q. Well, at that time you did not make an underground—any study of underground conditions, did you? A. What do you mean?

Q. Reservoir conditions, for instance?

A. I certainly got all the information which could be obtained from the Shell and Union Oil Companies as to underground conditions.

Q. At the time you made your estimate in 1938 you did not have that detailed information? [484]

A. I had all that was available at that time.

Q. But you did not have the detailed information, did you?

A. I had all the information which the Shell Company could give me.

Mr. Melville: I might point out, your Honor, that through the opposition of Petitioner's counsel, his appraisal as to 1938 was kept out of the record. I don't believe, in view of the fact that it is not in the record, his method of arriving at it is particularly important.

Mr. Mackay: Well, if your Honor please, he referred to reserves—I will pass that.

The Court: You withdraw the question?

Mr. Mackay: Yes.

Mr. Melville: I will be glad to stipulate in the record his entire 1938 report, which consists of only two pages, the summary.

Mr. Mackay: I think that is to generous.

(Testimony of Louis H. Evans.)

By Mr. Mackay:

Q. Do I understand you to say that in your opinion the fair market value of the Reyes lease of the oil royalty on the Dominguez Estate Company was around \$4,000,000.00?

A. \$4,000,000.00 is the figure I testified to.

Q. Do you arrive at that before taking into consideration income taxes? [485]

A. Certainly I do.

Q. I beg your pardon? A. Certainly.

Q. So that is your figure arrived at before you take into consideration income taxes?

A. Yes, sir.

Q. Now, do you mean by that that the buyer would not consider income taxes in arriving at the fair value? [486]

A. It is my experience that both the buyer and the seller today are very acutely aware of income taxes, and that I do consider the effect of income tax on values. It has a rather curious effect. There would be a lot more homes available for sale in this town today if people were not afraid to sell them at enhanced values because of the terrible income tax you have to pay on them. So, the effect of the income tax, as I analyze it, is to increase values rather than to reduce them.

Q. Isn't it true that the price which the investor is willing to pay for a property is determined on the basis of the future net yield after the payment

(Testimony of Louis H. Evans.)

of tax on income and proper provision for the return of capital?

A. Will you state the question again?

Mr. Mackay: Please read it, Mr. Reporter.

(The question was read.)

The Witness: I do not use it that way.

By Mr. Mackay:

Q. Well, you were trying to put a value on the future expected income, weren't you?

A. Yes. I find myself, and you will too very quickly, in a very curious anomalous position if you try to take in income tax in arriving at the value of a property. I know that certain appraisers do in the case of a corporation before capitalizing income consider that as an element of value [487] of the property and do deduct the income taxes. The appraiser that does that and gets on the witness stand is going to be forced to admit that he can arrive at an indefinite number of values. I can just cite the case of two buildings identical and similar in every respect, one owned by a corporation and the other by an individual, and you get two different answers for the same or similar thing. I do not propose ever to be asked to use income taxes in consideration of the value which I derive from income.

Q. Now, Mr. Evans, taking into consideration the estimated future income, let us assume that the taxes were 95 per cent and that on every dollar

(Testimony of Louis H. Evans.)

you got back from that production you had to pay 95 per cent to the Government, would that have any effect upon your value?

A. Not as to the fair market value.

Q. It would not? A. No.

Mr. Mackay: That is all.

The Court: Is that all from this witness?

Mr. Melville: I think I have one question, your Honor.

Redirect Examination

By Mr. Melville:

Q. If, as Mr. Mackay has suggested, a willing buyer took into consideration taxes in arriving at the price which [488] he would be willing to pay for a particular piece of property and if the willing seller of that property took into consideration the taxes in arriving at the price which he would be willing to accept for that property, what would the result be?

A. It is an old, old question. I had it in a very practical manner a number of years ago. One of my clients had asked me what price he should arrive at to buy or sell his partner out. There is no such price when you come to take income tax into consideration. The fair value would have been \$900,000.00, but he could not afford to buy it for more than \$600,000.00—let me see if I get this thing straight—he could not afford to sell for less than \$1,200,000.00, and he could not afford to buy at a price of \$900,000.00, or some such figure as

(Testimony of Louis H. Evans.)

that. When you get income tax mixed up in a question of value of property everything goes haywire.

Q. And in that particular case you just cited, was there a sale consummated? A. No.

Q. All right. If there is no sale consummated between the willing buyer who takes income tax into consideration to arrive at the price which he will bid—— A. Hold it.

Q. I will start over again, if you wish, Mr. Evans. A. If you will.

Q. If the willing buyer in arriving at the price which [489] he is willing to pay or bid for a particular piece of property takes into consideration income taxes, and if the willing seller in arriving at the figure which he would be willing to accept takes into consideration income taxes and there is a wide variance between the bid price and the asked price, does either price establish, in your opinion, the fair market price?

A. No, the fair market price is the value which will obtain when the sale is made.

Q. Both of them absorbing their own income tax problems? A. Yes, sir.

Mr. Melville: No more questions.

Mr. Mackay: There are no more questions.

(Witness excused.)

The Court: We will suspend at this time until 2:00 o'clock.

(Whereupon, at 12:20 p.m., a recess was taken until 2:00 p.m. of the same day.) [490]

Afternoon Session—2:00 p.m.

Mr. Melville: Call Mr. Webb to the stand.

The Court: You may come forward.

EDWARD C. WEBB

called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: Your name, please?

The Witness: Edward C. Webb.

By Mr. Melville:

Q. Mr. Webb, what is your business?

A. The oil business.

Q. And are you employed? A. Yes.

Q. By whom?

A. General Industries Corporation.

Q. What position do you hold there?

A. President.

Q. And what business is the General Industries Corporation engaged in?

A. Development of its oil properties.

Q. Has that corporation ever bought oil royalties? A. Yes.

Q. Has it sold oil royalties? [491]

A. Yes.

Q. Is it engaged in business in Los Angeles?

A. That is right.

Q. How long have you been connected with this business? A. Since 1930.

Q. In connection with that business, Mr. Webb,

(Testimony of Edward C. Webb.)

have you found it necessary to value oil royalties?

A. Yes.

Q. When you value oil royalties, do you rely upon the information given to you by geologists and oil engineers?

A. Yes.

Q. You have had experience, have you, in translating into fair market value the data that the oil geologists and engineers furnish you?

A. Yes, I have had experience in translating their reports into recovery values.

Q. And into a determination of what the willing buyer and the willing seller would trade at?

A. Yes.

Q. Mr. Webb, have you been asked to study the facts that have been stipulated in this case, the Cotton case?

A. Yes.

Q. Did you study those with a view to arriving at an opinion as to the fair market value of the oil royalties of the Dominguez Estate Company?

A. No. My opinion on that is fixed by the prevailing market value at the time the transaction took place.

Q. You may have misunderstood my question. For what purpose did you study the facts that were given to you that are stipulated in this case?

A. To determine the location of the property as to its structure.

Q. And did you consider the amount of oil royalties that are anticipated to be received in the future, starting in 1941?

(Testimony of Edward C. Webb.)

A. I saw the estimate. I don't know who it was prepared by.

Q. I show you what has been marked as Joint Exhibit 11-K (2), which is the summary of probable future royalties and income from the oil properties of the Dominguez Estate Company as of June 5, 1941. Have you see the figures on that exhibit before?

A. I believe Mr. Grimes showed me these figures in my office.

Q. When Mr. Grimes showed you those figures, was it for the purpose of getting from you an opinion as to the fair market value of oil royalties in the Dominguez Hill as of June 5, 1941?

A. I believe that was the purpose.

Q. And did you express—did you give consideration [493] to the figures that were furnished you? A. No, I did not.

Q. Did you express any opinion with respect to the value of oil royalties as of June 5, 1941?

A. Yes, I expressed an opinion as to the market value.

Q. And what opinion did you express?

Mr. Mackay: I object to that, your Honor. I don't think the witness is qualified to give an opinion.

The Court: Well, I doubt the competency of the question as framed. I suppose you are leading up to asking him to express an opinion, is that correct, Mr. Melville?

(Testimony of Edward C. Webb.)

Mr. Melville: Well, off the record, your Honor.

The Court: Off the record.

(Discussion off the record.)

Mr. Melville: I will withdraw the question, your Honor.

The Court: Very well.

By Mr. Melville:

Q. Mr. Webb, on the basis of your experience, do you have an opinion as to what oil royalties bought and sold for in 1941? A. Yes.

Q. Do you have an opinion as to what oil royalties would be bought and sold for as of June 5, 1941?

A. Yes. [494]

Q. On what basis, in your opinion, would oil royalties be bought and sold for as of June 5, 1941?

Mr. Mackay: I object to that as incompetent, irrelevant and immaterial, and the witness not being qualified to answer, too general.

The Court: The question seems to be rather general but we will permit him to answer. The objection will be overruled.

The Witness: Well, you see, you are covering a rather broad and general survey there. Every field in the United States has different producing conditions, different recovery conditions, and different demand for the royalties, and unless you specify the field particularly I could not give you

(Testimony of Edward C. Webb.)

an answer that would be in any way enlightening on that question.

By Mr. Melville:

Q. Thank you, Mr. Webb. That is a good point. I am referring to the Dominguez Oil Field. Are you familiar with the Dominguez Oil Field?

A. Yes.

Q. Have you ever heard of the Reyes lease?

A. I am not familiar with the leases particularly. I am familiar with the field and its reputation and the general character of it.

Q. What is its reputation? [495]

A. Considered among what we call the Class A fields.

Q. One of the best? A. Yes.

Q. Now, then, going back to the other question, do you have an opinion as to what a willing buyer and a willing seller would have agreed upon as the market price or fair market price of oil royalties from the Dominguez field as of June 5, 1941?

A. Yes.

Q. What is that opinion?

Mr. Mackay: I object to that, if your Honor please, as incompetent, irrelevant and immaterial, and no proper foundation laid, too general, not within the issues of the case.

The Court: I am inclined to think that the witness may have shown that he is not qualified to answer as to the Reyes lease unless you perhaps

(Testimony of Edward C. Webb.)

show him these maps and call his attention to the location of the field that we are dealing with.

By Mr. Melville:

Q. Here is a map, Mr. Webb, that is marked Joint Exhibit 17-Q. This diagonal piece with all these lines in it is the Dominguez field, and the part here is the Reyes lease (indicating). All of the properties on this map circled in red constitute leases which belong to the Dominguez Estate Company.

A. Are they part of the interests involved in this case? [496]

Q. They are part of the oil royalties which we are trying to value in this case.

A. Is this particularly here a part of it (indicating)?

Q. That is a part of it, that is a part of it, that is a part of it, that is a part of it, and that is a part of it (indicating). Now, on this they have a joint interest with the Carson Estate Company, this little piece up here (indicating).

Now, on Joint Exhibit 18-R, these five pieces, this small one here, this larger one, these two and this little one over here (indicating) all are Dominguez Estate Company properties which we are trying to value.

A. In the Torrance Field?

Q. That is right. This is in the Wilmington Field and a very little bit is represented by that

(Testimony of Edward C. Webb.)

small square. This Joint Exhibit 20-T is in the Hildon-Caminole-Victory Field (indicating).

Mr. Mackay: If your Honor please, I object to the question. It is a leading question.

Mr. Melville: I am explaining the exhibits. As counsel knows, I was not furnished a copy of these exhibits——

The Court: You need not argue, gentlemen. I will overrule the objection.

Mr. Mackay: I will withdraw the objection to the maps. [497]

By Mr. Melville:

Q. This map, Joint Exhibit 20-T, is a map of the Hildon-Caminole-Victory Field, and the Cross-Hatching represents that the properties here are jointly owned by Dominguez and Carson. I believe the evidence shows, and I think I am quoting correctly when I say, that 90 or 75 per cent of the oil royalties that we are dealing with here are represented in this one Reyes lease right here on this map (indicating); 90 to 95 per cent of the oil royalties that we are valuing are represented by this one lease in the Dominguez Hill.

A. I am not enough familiar with the other royalties concerned to express an opinion anyway at Torrance and Wilmington. There have been some very wide and fluctuating conditions in those two fields.

Q. Are you willing to testify as to only the Reyes lease?

(Testimony of Edward C. Webb.)

A. Yes, I am willing to testify as to what I think the fair market value would have been for it at that time, what I as a broker and dealer could have sold it for.

Q. I think that is what we are after, so I will ask you the question, what, in your opinion, could the oil royalties involved now, only with respect to the Reyes lease, have been sold for as of June 5, 1941?

Mr. Mackay: Just a moment. If your Honor please, [498] I object to that as incompetent, irrelevant and immaterial. It has not been developed that this witness knows anything about the stipulations and the exhibits or that he has shown sufficient familiarity with the property to qualify him as a witness on an estimate which this Court could depend on for an opinion. I think it is incompetent, irrelevant, and immaterial.

Mr. Melville: Your Honor, it seems to me that there are two ways of approaching the problem that we have. One is to call geologists and engineers who know how to go out and determine the amount of oil in the ground, approximately, and the rate of exhaustion, and they get all through and they arrive at a total anticipated income, and by applying certain discounts they give an opinion as to what they think the fair market value should be. Another way to approach our problem, it seems to me, is to call a man who does not know as much about the oil properties, perhaps, as the engineer who has worked over them, gone over the ground

(Testimony of Edward C. Webb.)

day by day over a period of years, but who has dealt in the oil royalties of good fields and bad fields and has seen the buyer lay out his hard cash to buy an oil royalty on a certain basis, a man who has seen the seller accept that money in exchange for his oil royalties. That, is seems to me, is just as good a yardstick for valuing the fair market value of oil royalties, if not a better one, than the engineer who determines how much [499] oil is in the ground and how much the willing seller should ask for it, whether or not he can get it.

The Court: Well, the difficulty with your question as now phrased is that I am in some doubt as to just what you are trying to prove by this witness. Now, I don't understand that he is being presented as one who has gone upon the Reyes lease and made all of the appropriate tests for determining the value of the property which he saw, nor do I understand that he has been shown the basic stipulated facts in this case as they pertain to the Reyes lease, so that you are in a position to ask him to express an opinion as to the fair market value of the estimated probable total less reserves, or the estimated royalty, and how much will be secured from it. I don't say that critically, Mr. Melville, but I am only trying to find out for the purpose of ruling upon this objection just how we have this, just what you are trying to prove by him.

(Testimony of Edward C. Webb.)

Mr. Melville: I will be glad to withdraw the question, your Honor, and try again.

The Court: Very well.

By Mr. Melville:

Q. Mr. Webb, do you deal in oil royalties on the payout basis?

A. Well, of course—let me explain that. I have not dealt in royalties since 1940. That was the last activity [500] our company had so far as buying, trading, or brokeraging royalties, at the close of 1940. Acting in the capacity of a broker, and also as a distributor of them, and as a purchaser for our own ownership, our own investment, we used both methods. The demand was so great for royalties along at that period——

Mr. Mackay: If your Honor please, I object to that.

The Court: Overruled. He may proceed.

A. (Continued) Well, your Honor, I may digress a little bit here from the legal side of this question. I am just trying to explain what my position in the business has been so everybody will understand what my testimony is.

The Court: You may proceed.

A. (Continued) On this, what we call the short payout stuff, that is, where you have flush production and rapid return of the money, the recovery never was so paramount and important in the purchase of that type as the stuff where it extended over a longer term of years. Where it ran into a

(Testimony of Edward C. Webb.)

longer term of years, anywhere from six to twelve years, of course the matter of recovery at deep sand potentialities all entered to quite a large extent in our decision on whether we would handle it or sell it. This particular type of royalty under question here, of course, would be one that I would consider a long term pay-out, and, naturally, recovery would be an important factor if we were at that time considering the royalty for purchase and sale. But to qualify the first part [501] of my answer there, I was going to say that the demand was so great at that period by the buyers and investors for royalties that they were willing to take the better class pools, what we call the Class A pools, on an extremely long term pay-out basis, and some consideration was given at that time, some thought, to the possibility of a substantial increase in the price of the oil, a substantial increase, perhaps, in the allowed production from the wells, which, of course, would have shortened the pay-out period. Quite a considerable consideration was given to the deep sand possibilities and they were willing to pay some speculative value for that.

Now, as to whether or not we used any one particular yardstick in determining our basis for purchasing, depended somewhat upon the attitude of the buyer at the time. It was not so much in that period what you had to sell as it was what you could get to sell. There didn't seem to be much difficulty in selling it. The distribution and sale of the royalties were governed by the proper State

(Testimony of Edward C. Webb.)

and Government agencies which supervised the selling price and the manner of distribution.

By Mr. Melville:

Q. Well, on good oil royalties, such as we have represented in the Reyes lease, what were they being bought and sold at on the pay-out basis in 1941?

Mr. Mackay: I object to that as incompetent, irrelevant, and immaterial, no proper foundation laid. [502]

The Court: If he knows he may answer.

The Witness: Well, if we could have secured a royalty of that quality and in that particular lease, it is my opinion that we could have sold it easily on one hundred times its monthly pay-out or its monthly return.

Mr. Melville: No more question. [503]

Cross Examination

By Mr. Mackay:

Q. Mr. Webb, you have never been on the property? A. No, never have.

Q. You have never made a study of the lease?

A. No.

Q. Or the lease document?

A. No, I have not seen the lease document.

Q. Do you know the lease conditions?

A. Well, not in detail.

Q. You have never studied the lease, have you?

A. I know the reputation of the field.

(Testimony of Edward C. Webb.)

Q. Just the reputation? A. Yes, sir.

Q. Do you know whether the production was declining about this time or inclining?

A. No, I don't know.

Q. You don't know anything about that?

A. No. I would assume that it was declining.

Q. You would assume it was declining?

A. That is, it was several years old.

Q. You have made no investigation to determine that, have you? A. No.

Q. Did you, in your figure, take into consideration [504] income taxes?

A. No, my opinion there was before taxes.

Q. Before taxes? Well, assume that out of every dollar that is recovered, Uncle Sam would take 95 per cent, would that affect the value, in your opinion?

A. Well, I don't think it would, due to the fact that the taxpayer's status would be different in practically every case. One man would be up against a 95 per cent condition where another might be exempt.

Mr. Mackay: That is all.

Mr. Melville: No more question. You are excused.

The Court: May I ask the witness one question? I don't understand what you mean by 100 times each monthly return. If you take a group of leases having a monthly return of, say, \$60,000.00 a month in 1942, but with an estimated return of less than

(Testimony of Edward C. Webb.)

half of that 10 years later, where do you get your 10 times monthly return under those figures?

The Witness: Well, your Honor, technically it is a very erroneous way to figure values. It is a method that is used in royalty trading in the business quite generally, more particularly as concerns the short pay-out leases, the idea being at the time to probably estimate how soon you might expect a return of your cost, based somewhat upon the anticipated life of the flush production before the wells go into their secondary production stage or life. [505]

Mr. Melville: Your Honor, I think I can clear this point up.

Redirect Examination

By Mr. Melville:

Q. This Exhibit 11-K (2) shows that according to the stipulation of the parties the Reyes lease would receive during the last seven months of 1941 \$368,645.00. Do you see that figure there? That is up to May 31st.

A. Of course, the way we calculated that to determine what the average monthly pay-out was, we would probably have taken the previous 12 months' production, taken the average for the previous 12 months or some such period, and then used our basis of calculation upon that average per month during that period. Of course, you might have one particular month that might be very high and

(Testimony of Edward C. Webb.)

another very low due to some peculiar local condition or mechanical trouble, and so on.

Mr. Melville: May I suggest, your Honor, that we give the witness the income according to the stipulation for the year 1940 and have him use that—the last 12 months' average monthly pay-out—and work out his problem?

The Court: You have the stipulated income from the lease only?

Mr. Melville: I believe we have, your Honor.

The Witness: I examined before coming up here——

The Court: You better wait a moment until a [506] question is asked you.

The Witness: I didn't know whether you wanted me to answer your question.

The Court: I did not care to interrogate you, sir. Wait until counsel asks a question.

The Witness: I see.

Mr. Melville: No wonder I could not find it, your Honor. It is not in the stipulation. The future figures out but not the past figures by leases.

The Court: I did not remember having seen it. Do you have any other questions, Mr. Melville, of the witness?

Mr. Melville: No, your Honor.

Mr. Mackay: No, your Honor.

The Court: I have no desire to cross examine him myself, gentlemen. I was just merely trying to get an explanation of that answer of his as applied to

this case, that is all. You may stand aside, Mr. Webb.

(Witness excused.)

Mr. Melville: Call Mr. Pemberton, please.

JOHN R. PEMBERTON

called as a witness by and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows: [507]

Direct Examination

The Clerk: Your name, please?

The Witness: John R. Pemberton.

By Mr. Melville:

Q. Mr. Pemberston, what is your business?

A. I am a consulting petroleum geologist and engineer.

Q. Will you please state your educational and professional qualifications?

A. Yes. I was graduated from Stanford University in 1909 as a geologist, and worked for the United States Geological Survey in a portion of 1909 after graduation. I was an instructor in geology in Stanford University in 1910. I was then employed as a geologist by the Argentine Government for five years in land classification. I returned to this country and entered the employ of the Ventura Refining Company, a producing company in California. I then went to Oklahoma and was engaged in the business of exploration and

(Testimony of John R. Pemberton.)

geological work, and later development and production of oil for seven years in the Midcontinent. I then returned to California and was employed by the Petroleum Securities Company and the Pan-American Petroleum Company for eight years, during time I had charge of drilling and producing oil, management of properties, and also the geological work. In 1932 I was chosen as what is known as the Oil Umpire for the petroleum producing business within the state [508] and held that office for eight years. That work involved keeping statistics on production of crude oil in the state and the issuance of so-called allocation schedules of curtailment, the object of which was to keep the supply of crude oil commensurate with the consumptive market demand. Since 1940, the early part of 1940, I have been in business for myself.

Q. Have you had experience in valuing oil royalties?

A. Yes, sir; a great part of my work has been and is now the determination of value for market value of royalties, producing properties, and oil interests.

Q. Have you testified in court as to the value of oil properties and oil royalties?

A. Yes, sir.

Q. Were you recently retained by our worthy opponent, Mr. Mackay, to testify in a case as a witness on oil royalties and oil property valuation?

A. It was in connection with the value of a

(Testimony of John R. Pemberton.)

property as of March, 1913, for the determination of capital gain or loss.

Q. It was an oil property?

A. Yes, sir, an oil property.

Mr. Mackay: Not an oil royalty?

By Mr. Melville:

Q. You have seen the exhibits that have been [509] introduced as part of the stipulation in this case insofar as they would give you, or insofar as you needed to go into, the factors to determine the fair market value of the oil royalties of the Dominguez Estate Company as of June 5, 1941?

A. Yes, sir, I have seen them.

Q. Did you study them? A. Yes, sir.

Q. Did you study them with a view to formulating an opinion as to the fair market value of the Dominguez Company's oil royalties as of June 5, 1941? A. Yes, sir.

Q. Did you form an opinion?

A. Yes, sir.

Q. What is that opinion?

A. It is my opinion that it was worth \$4,000,000.00.

Mr. Melville: No more questions—yes, I will ask a few more questions.

By Mr. Melville:

Q. Did you check after you arrived at your opinion of \$4,000,000.00—did you check your method of appraisal with the same method of appraisal which has resulted in actual sales?

(Testimony of John R. Pemberton.)

Mr. Mackay: I object to that, your Honor, as a leading question.

Mr. Melville: I asked him if he did. [510]

The Court: Overruled. You may answer.

A. Yes, sir, I did.

By Mr. Melville:

Q. Would you explain to the court the sales you checked it with and the result of your check?

A. A number of years ago, in 1936, to be explicit, I appraised a property similar in many respects to the Dominguez Estate's properties in the Ventura Avenue oil field and determined a value of that property for an inheritance tax case. The appraisal was accepted by the government and by the court and the tax was paid. The taxpayers did not have enough money to pay the tax and it was necessary for the taxpayers to borrow money or sell the property to get the money to pay the taxes, apparently. They elected, rather than to borrow, to sell, and they sold an interest in the royalty. They sold a 35 per cent interest of a one-eighth royalty, using my appraisal as a basis to determine what the value of the interest sold was as of the date of sale. In checking that against the sales price I arrived at a factor or a percentage, you might say, which would be a percentage which had been applied to the value that I had determined in order to determine the fair market value by the purchaser and the seller, and applied that percentage to the value that I worked out for the Dominguez

(Testimony of John R. Pemberton.)

Estate property, using the same method of figuring in both cases, and arrived as a [511] figure of close to \$4,000,000.00. To be explicit, the figure that I reached was \$3,871,000.00. My opinion is that market conditions for royalties and money were very much easier in 1941 than they were in 1938, and that had this interest been sold under those conditions it would have received \$130,000.00 more to make an even \$4,000,000.00.

Mr. Melville: You may cross examine.

Cross Examination

By Mr. Mackay:

Q. What price did it sell for?

A. What is that?

Q. What price was that sale you had, Mr. Pemberton?

A. The property was sold for—the interest was sold for \$1,842,105.30. That was, however, 35 per cent of a one-eighth royalty.

Q. What were the estimated reserves in that?

A. The estimated reserves as of that time?

Q. Yes. A. 8,600,673 barrels.

Q. What did that figure out per barrel in the ground? A. 74.19 cents a barrel.

Q. You are sure that is not 60.4?

A. No, 74.19—oh, excuse me. That is the value that the seller had set up. In this sale the seller took a capital loss of \$391,000.00. The cost to the buyer per barrel [512] was 61-1/3 cents, approximately.

(Testimony of John R. Pemberton.)

Q. That oil was 1.57 per barrel oil, wasn't it?

A. No, I believe not.

Q. Oil, gas and gasoline, I am talking about.

A. It probably was, yes, the revenue, yes.

Q. At \$1.57? A. Yes, it probably was.

Q. And so you used that as a comparison with this, Mr. Pemberton? A. Yes, sir.

Q. Now, is it not a fact that the lessee in that deal got a very substantial modification of the lease terms?

A. No, I know of no changes in the lease. If they occurred, I never heard of them.

Q. Do you know that there were not?

A. I have appraised that same lease just about a month ago and I ran across no changes in the lease.

Q. You really don't know whether there were some lease modifications in that deal?

A. I do not know that there were not, but I have—I am sure that there were none of any consequence, affecting the value in any manner.

Q. If you don't know there were any, how do you know they did not affect values?

A. All the terms of the lease that affect value are [513] the same now as they were in 1936.

Q. Is it not a fact that there was a modification there with respect to further drilling by the lessee, and that the lessee wanted to get relieved of those further drilling requirements?

A. I don't know about that.

(Testimony of John R. Pemberton.)

Q. You didn't go into that when you made that valuation? A. No, I did not.

Q. So, Mr. Pemberton, then, you are preparing that sale of \$1.57 with \$1.13 oil in this case, aren't you?

A. No, I am not comparing them.

Q. You are not comparing them?

A. No.

Q. I understood you to say that one of your tests was the deal you made—the value you placed on there and the sale that was made.

A. Yes.

Q. And you testified that was \$1.57 oil? Now, in the facts here it has been stipulated it is \$1.13 oil in this case. Do you think that is a fair comparison? Wouldn't you get more for \$1.57 oil than you would for \$1.13? You know that is right, don't you, Mr. Pemberton?

A. Yes, of course.

Q. It would make quite a difference? [514]

A. In this case I have had nothing to do with barrels. I have been furnished with a stipulated schedule of future earnings by years, a certain amount of earnings by years, and I have determined that the fair market value of those earnings is \$4,000,000.00. Now, as to how many barrels it represents, I have not been advised.

Q. You have not been advised as to the number of barrels?

A. No, nor how many dollars per barrels that represents.

(Testimony of John R. Pemberton.)

Q. Let me ask you this question: If your oil was worth 60 cents in the ground, based upon the \$1.57 value, as you stated, what would this at \$1.13 be worth in the ground?

A. Well, I don't—

Q. You would not have an opinion on that?

A. I don't grant you can make comparisons of that kind.

Q. All right. When were you down on the Dominguez lease?

A. Oh, I was through there about four or five months ago.

Q. Not to make an examination?

A. No, before I heard of this controversy.

Q. And since you heard of this controversy you have not been down there? A. No.

Q. You have not studied the well production?

A. No.

Q. You have not studied the operations down there? A. Now?

Q. Yes. A. No.

Q. Not for this case? A. No.

Q. You merely took the figures here that were presented to you in this stipulation?

A. Yes.

Q. And you did not see any barrels in there? You just saw the revenue and made your valuation on that? A. That is correct.

Q. Did you regard that revenue shown on the stipulation as absolutely definite revenue?

A. Yes.

(Testimony of John R. Pemberton.)

Q. You felt that was very definite revenue, did you?

A. Well, it was a schedule showing some \$9,000,000.00 spread over 35 years, stipulated to by both parties in this controversy, which established adequate grounds for me to assume it was solid and basic and fundamental.

Mr. Mackay: That is all.

Redirect Examination

By Mr. Melville:

Q. Mr. Pemberton, on the basis of your experience in [516] valuing oil royalties, were you given in the stipulations that you received all of the information which you thought was necessary in order that you would not have to go down to the oil fields to look them over?

A. Well, I can answer that, yes, because when I make a valuation of a royalty as of a certain date, I shut my eyes as to everything that happened after that date. We are concerned with the data right up to that time and I don't bother to find out what the true production is. Right now I am appraising a property as of 1941. I don't like to look at the production of that property in 1942 and 1943 to guide me in appraising it.

Q. Mr. Pemberton, did the government's representatives tell you to disregard any opinion which you might have which would alter the agreed stipulation of facts, and stick squarely to the stipulation of facts in arriving at your opinion?

A. Yes, sir, they did.

(Testimony of John R. Pemberton.)

Q. And did you do that?

A. Yes, I did, of course.

Q. Mr. Pemberton, you stated an opinion as to \$4,000,000.00 as your value of the Dominguez oil properties in June, 1941, and then you referred to another sale. Did your reference to that other sale do any more than prove or disprove the accuracy of your methods of appraisal?

Mr. Mackay: I object to the question as leading. [517]

The Court: Well, I presume counsel is asking him whether or not in his opinion they coincide.

Mr. Melville: I will pose the question again, your Honor. I will withdraw that.

By Mr. Melville:

Q. Mr. Pemberton, did you compare or did you try to compare the properties that were involved in the Grubb Estate sale with the properties that are involved in this case, or, on the contrary, did you simply compare your methods of valuation as tested in the Grubb Estate by an actual sale with your methods of valuation in this case?

Mr. Mackay: The witness has already answered that.

A. Yes, that is what I did.

By Mr. Melville:

Q. Which? A. The latter supposition.

Q. You did not make any comparison, then, as I understand it, of the oil properties involved in the Grubb Estate case with the oil properties in this case? A. No, I did not.

(Testimony of John R. Pemberton.)

Q. Only your method of valuation was compared?

A. Exactly, because I had no basis for making a comparison of oil properties inasmuch as I had been served with a stipulated scale of future revenue, and that is all [518] I was concerned with.

Q. Do you think it would be fair for you as an engineer, and if you had knowledge of the oil properties involved here, such as one who works over the field every day—would it be fair, in your opinion, to interpose your own views on top of the stipulation and let those views influence your opinion?

A. No, it would not be proper.

Mr. Melville: No more questions.

Recross Examination

By Mr. Mackay:

Q. Now, Mr. Pemberton, did you give consideration to income taxes? A. No.

Q. Isn't it true that the price which an investor is willing to pay for a property is determined on the basis of future net yield after the payment of tax on income and proper provision for the return of capital?

A. I should modify my answer when I said "No" to your first question. The determination of fair market value as a part of an engineering estimated present worth value does contain an element of income taxes, yes. So, in determining a fair market value I do take into consideration income taxes.

(Testimony of John R. Pemberton.)

Q. How much did you take into consideration here? A. How much?

Q. Yes. [519]

A. How do you mean, how much?

Q. Well, we had pretty heavy taxes in 1941.

A. I did not make any computations particularly. My opinion is that, generally speaking, a reduction of a discounted present worth calculated value anywhere from 75 to 85 per cent is a good figure to use to determine a fair market value. Now, then, the amount of discount there is dependent a good deal on the rate at which the earnings are going to come back. I am a firm believer that a fair market value of a property ought to be something around what the property will turn back in about five years. I don't like the eight and ten-year pay-outs.

Q. All right, Mr. Pemberton, let us just assume that the tax rate in 1941 was 31 per cent.

A. The tax rate on whom?

Q. Well, let us assume on the corporation who may want to buy. A. On a buyer?

Q. Yes. A. Yes.

Q. So, let us assume that at the very day that was received by the buyer it had to pay 30 cents out to Uncle Sam.

A. He does not have to——

Q. Well, 30 cents on the profit.

A. Yes, he takes his depletion out and pays his 30 [520] per cent on the remainder.

(Testimony of John R. Pemberton.)

Q. Let us assume it is 30 cents at that time on every dollar less depletion. A. Yes.

Q. And that he has to pay the State of California, say, 3 per cent. Now, how much or what discount factor would you use under those circumstances to arrive at the fair value of that expected income?

A. Well, as I say, I don't know a good way to determine those things. Generally speaking, anybody that can buy this kind of a royalty and has that kind of money and is dealing in that is certainly going to be in that much of a bracket or more.

Q. Yes, or it would be more than that?

A. Yes, it is certainly going to be more than that. This schedule of stipulated receipts which was handed me shows that it will pay out \$4,000.00 in five years.

Q. \$4,000,000.00 in five years? A. Yes.

Q. Of course, that is before taxes, isn't it?

A. That is the receipts.

Q. Yes, I know, but that would be before taxes?

A. Yes, but it is going to return \$9,000,000.00, or \$5,000,000.00 more.

Q. I know, but you are taking it now for the five [521] years? A. Yes.

Q. Now, suppose that you take 30 per cent or, say, 33 per cent, and that is a rather reasonable bracket, out of that, how long will it take to get back, I mean, to get the capital back?

A. Well, of course, that could be calculated by

(Testimony of John R. Pemberton.)

taking out the depletion and finding the taxable amount——

Q. Let us take your——

Mr. Melville: Let him answer it.

By Mr. Mackay:

Q. I am sorry. I beg your pardon.

A. ——and determining what he would save in five years, of course.

Q. But you think a five-year pay-out is reasonable, don't you?

A. Yes, I think that a five-year pay-out is a good basis.

Q. And that is after taxes, of course, that you get your money back in five years? That is what you mean, don't you?

A. No, I don't mean that. No, I mean that the property itself would return that much money in five years.

Q. No matter what the tax may be?

A. Well, obviously a man who is in such a high tax [522] bracket that he could not afford to pay such an amount because he never would get his money back would not buy it, that is true. So, we will assume that there must be buyers who are in such a tax bracket that they have the money and can afford to buy the royalty on a five-year gross pay-out.

Q. All right. Now, let us just assume that we have that man who is in the 33 or 35 per cent bracket—let us make it easy—the 30 per cent bracket, for instance, and we have a stipulated

(Testimony of John R. Pemberton.)

figure here for the last seven months of 1941 of gross receipts of \$412,652.00. Now, will you please deduct 27½ per cent for depletion from that?

A. Well, he would have more than 27½ per cent depletion.

Q. All right. A. The buyer would.

Q. All right, you put that on a cost basis, then.

A. Obviously the buyer would. He would have capital depletion.

Q. All right, suppose you take 50 per cent of it.

A. He might have more than 50 per cent. In the case of the Grubbs, they had 74 cents a barrel, and on your figure it was 60 cents a barrel, so it would be probably more than 50 per cent, his depletion would be.

Q. Well, I think you made—I will withdraw it. I think you stated that in your opinion it was worth [523] \$4,000,000.00?

A. That is right.

Q. Let us assume that that is the cost. Now, let us assume——

A. How many barrels would he have bought? I would like to know that.

Q. Let us assume that a man paid \$4,000,000.00 for that, that he is in a 30 per cent bracket, and the first seven months in 1941 he receives \$412,652.00. What would be the depletion for that on cost, Mr. Pemberton?

A. Well, I don't know what it is because I don't know how many barrels the stipulation refers to.

Q. Oh, you don't know how many barrels the stipulation refers to? A. No.

(Testimony of John R. Pemberton.)

Mr. Mackay: No further cross examination.

Redirect Examination

By Mr. Melville:

Q. Mr. Pemberton, in the Grubb Estate sale, which is the one you made the comparison with—is that correct? A. Yes.

Q. ———who was the buyer?

A. Shell Oil Company.

Q. Did you suppose that the Shell Oil Company had a tax problem? [524]

A. I suppose they have.

Q. And who was the seller?

A. The seller was the Estate of Alice Grubb.

Q. And did you suppose or assume that they had a tax problem? A. I know they did.

Mr. Mackay: I will admit that everybody has got a tax problem.

The Court: We could almost take judicial notice of that.

By Mr. Melville:

Q. So that if your method of valuation was proved to be substantially correct by an actual sale between a willing buyer, the Shell Oil Company, and the Grubb Estate, a willing seller, both with tax problems, would that assume that your method—I mean, would that establish in your opinion that your method of valuation takes into account adequately the tax problem?

A. Yes, sir, I believe it does.

(Testimony of John R. Pemberton.)

Q. Did you give as much consideration to the tax problem in this case—withdraw that.

Did you use the same method of valuation in this case, the same underlying principles of valuation in this case, as you did when you testified for Mr. Mackay in the other case? [525]

A. No. They didn't have any royalty out there at all. Their situation was——

Q. Quite different?

A. Quite different.

Mr. Melville: No more questions.

Recross Examination

By Mr. Mackay:

Q. Mr. Pemberton, is it not a fact that the Shell Oil Company was also the lessee of the Grubb Estate? A. Yes.

Mr. Mackay: That is all. May we have a recess, your Honor?

The Court: Yes, we will suspend at this time for a brief recess.

Mr. Melville: The witness may be excused.

(Witness excused.)

(Short recess.)

Mr. Melville: Mr. Clute, will you take the stand?

WALKER S. CLUTE

called as a witness by and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: Your full name, please, for the record? [526]

The Witness: Walker S. Clute.

By Mr. Melville:

Q. Mr. Clute, what is your business or profession?

A. Consulting geologist and petroleum engineer.

Q. How long have you been engaged in that business? A. 25 or 26 years.

Q. Would you please state for the record your educational and professional qualifications?

A. I took my training at Stanford University and graduated from that university in 1915 with a degree in geology and mining. In 1915 and 1916 I was Deputy Oil Inspector of the City of Los Angeles. In 1916 and 1917 I was with Smith, Emery & Company, Chemical Engineers, in Los Angeles, and my work included the Potash Development Company in Nebraska. In 1917 I was engineer and geologist with the Petroleum Midway, California Star, and Pan-American Petroleum Companies in the Montebello field in California. In 1918 I was with the United States Army Air Corps. In 1919 and part of 1920 I was connected with Harry E. Johnson, petroleum engineer, in Los Angeles, in-

(Testimony of Walker S. Clute.)

cluding geological work in Texas and Oklahoma and New Mexico, Arizona, Wyoming and California, and including also in 1920 exploration and geology for the Granada Oil Company in Colombia, South America. In 1921 and 1922 I was Oil and Gas Valuation Engineer with the Bureau of Internal Revenue in Washington, D. C. From 1923 until 1929 I maintained [527] my own office as a consulting engineer in Los Angeles. In 1929 and 1930 I was Field Superintendent in charge of drilling and production for the Wyoming properties of the Atlantic and Pacific Oil Company.

In 1930 and 1931 I was with the United States Geological Survey in Washington, D. C., and also in 1931 head of the U. S. Geological Survey Office in Tulsa, Oklahoma, in charge of drilling and production on Indian lands. In 1932 and 1933 I was head of the Oil and Gas Section of the California State Tax Research Bureau, and since 1934 up to the present time I have maintained my own office as consulting engineer and geologist in Los Angeles with certain assistants and a staff of engineers.

Q. Have you had experience in valuing oil properties and oil royalties?

A. Yes, a large percentage of my work has been valuation work. I think I have appraised, the last estimate I made, something in the neighborhood of \$800,000,000.00 worth of producing properties and royalties, not including refineries, which would be refineries and refinery methods and which would be in addition to that.

(Testimony of Walker S. Clute.)

Q. Were you furnished the facts which have been stipulated in this case with respect to oil royalties of the Dominguez Estate Company?

A. I have been furnished with them and I have read [528] them, yes, and studied them.

Q. Did you, on the basis of those, make an appraisal with a view of formulating an opinion as to the fair market value on June 5, 1941, of the oil royalties of the Dominguez Estate Company?

A. I did make an appraisal, and I want to say first that I have read over the stipulation and I find that the stipulation includes a schedule of expected royalty revenue beginning in 1941 and extending until 1965 and thereafter in the amount in dollars of \$9,029,979.00, and it is further stipulated that the number of barrels of royalty oil to go with that is 7,992,871 barrels. Now,—

Q. You studied—were you through?

A. No, I am not, because you asked me if I had been furnished the facts. Now, these, in my understanding, are the facts on which this is to be predicated now. So, when you asked me if I have been furnished the facts, I wanted to make that clear that to my mind that is the start.

Q. Very well. I know what you have in mind, so I will bring it out. When this case was coming on for trial approximately a year ago were you retained to make an appraisal of the oil royalties of the Dominguez Estate Company?

A. Yes, I was.

(Testimony of Walker S. Clute.)

Q. And did you make that appraisal without the benefit of any stipulation? [529]

A. Surely, yes.

Q. When you were again brought into the case this year, did the government representatives tell you to forget any estimates or appraisals or facts which you formulated or relied upon a year ago, and to rely strictly upon the stipulated facts in this case in formulating your opinion?

A. Very well. They did not tell me exactly to forget it because I do not suppose a person can divorce those things in their own mind from what they have seen before, but I was instructed that here was the basis, as I say, and that we were now to move over and see what this stipulated revenue is worth and—oh, yes. So, that was agreeable to me because in looking over this stipulation here compared with what I had done before they are substantially enough in agreement so that I could comfortably accept this. Is that clear?

Q. That is clear. Now, on the basis of the stipulated facts in this case, have you formulated an opinion as to the fair market value on June 5, 1941, of the oil royalties in the Dominguez Estate Company? A. Yes.

Q. Will you please state that opinion?

A. Well, my opinion is that the value as of June 1, 1941, was \$4,450,000.00.

Q. You said June 1st; the question was June 5th. Have you formed an opinion as to the value on June 5th? [530]

(Testimony of Walker S. Clute.)

A. June 5th is what I meant. If I made an error of a few days, it is June 5th.

Q. Now, will you please tell the court how you arrived at that opinion?

A. Yes. I started with the rate of production that was laid out and stipulated to. I am perfectly aware that when you have revenue coming in the future that you should recognize the present value of that production, so I made a computation at a rate of interest to start with which is called the 10 per cent rate of interest, that is to say, a discount factor of 10 per cent, and I discounted that revenue at 10 per cent, and I see that the present worth of that revenue amounts to \$4,859,625.00. That is the mathematical calculation on the thing. Well, now, in my mind that for many—I will just say at this point that for many ordinary cases that is perfectly understandable and that is within reach of a fair market value of a property, and I have appraised properties on a figure arrived at at that point and have explained to the people who want this value that there is the value at a 10 per cent discount and that is the fair market value, but in this case I looked further, and, as royalties go, this is a big royalty, it is a very valuable royalty, and using the 10 per cent discount factor—well, it is a big royalty and in my mind taxes entered into it and so, giving it the proper study which I have laid out on a certain [531] schedule here, I reduced that by a further percentage which I thought was proper to recognize the extra tax burden on this

(Testimony of Walker S. Clute.)

thing, and that reduced my value to \$4,450,000.00.

Mr. Melville: No more questions—pardon me. Withdraw that.

By Mr. Melville:

Q. Mr. Clute, after you made your appraisal, did you then compare your appraisal methods with any other appraisals which you have made that have been proven by an actual sale?

A. Yes, I did.

Q. Would you tell the Court about that?

A. I had in mind an appraisal that I made of a certain royalty interest, and the appraisal was made for the purpose of demonstrating about what the fair market value might be for the purpose of a sale, purchase and sale. The sale was consummated and I think my appraisal was used as the basis. Anyhow, here is the way it went. I appraised the one-sixth royalty interest owned by the O'Day Estate in the Athens-Rosencranz Field as of November 1, 1944, in the amount of \$282,470.00. That appraisal was requested by the Citizens National Bank of Los Angeles.

Now, this same royalty interest was sold five months later for \$356,000.00 to the Union Oil Company and the Barnsdale Oil Company, 50/50. I will say also that they were the operators of the property before the property was offered [532] for sale to any comer, as far as I know.

In making that appraisal I used the same method that I speak of, as I used in this Dominguez Estate

(Testimony of Walker S. Clute.)

royalty here, determining for my own purposes the reserves and the future revenue to come, and then discounted that at the 10 per cent factor, and taking out county taxes, and then after county taxes that left me a present worth of \$282,470.00. Well, this property did sell five months later for \$356,000.00, and I don't know whether this is hearsay evidence or not, but the attorneys for the company said they added on another \$50,000.00 for what they considered real estate value, possible realty value to the property there that went with the royalty, and in the meantime there were some 150,000 barrels of royalty oil taken out in that five months, so that it balances up. I was somewhat short, I would say \$50,000.00—no, \$70,000.00 short of the actual selling price but I was on the low side with this method.

Q. In other words, the actual sale established, as I understand your testimony, that the method of appraisal, if anything, is conservative.

A. Yes.

Mr. Melville: No more questions.

Cross Examination

By Mr. Mackay:

Q. Now, Mr. Clute, I understand you to say that you [533] considered the 7,000,000 barrels and the probable revenue of \$9,000,000.00 and that you applied a 10 per cent discount there for interest and you arrived at a present worth of \$4,859,625.00?

A. Right.

(Testimony of Walker S. Clute.)

Q. And after that, then, you approached it from the—to get some discount because of the tax drag on the income that might come?

A. That is right, yes.

Q. Do you think that 9 per cent is a sufficient penalty to allow for the burden of taxes, federal and state?

A. 9 per cent for the burden you speak of, but am I to understand that is a 9 per cent tax on the——

Q. Gross revenue.

A. ——on the gross revenue that the buyer will sustain? A. That is right.

A. No, the seller is going to sustain——

Q. I am talking about the buyer.

A. You want an answer to that question?

Q. Yes.

A. No, I don't think 9 per cent is enough. I think it is going to be heavier than that.

Q. On the gross?

A. No, that is not heavy enough on the gross.

Q. That is not heavy enough on the gross, is it?

A. No. In an onstensible revenue of this size it is going to be more than that, something substantial.

Q. It would be around 30 or 40 per cent, wouldn't it?

A. I don't want to—I don't think it is 30 per cent. It is 20.

Mr. Melville: Your Honor, the question in this case is the fair market value of oil royalties in

(Testimony of Walker S. Clute.)

companies which various people might have to pay. I object to the question.

Mr. Mackay: I wish we could forget taxes that way, your Honor.

The Court: This is cross examination. Objection overruled. We will allow some latitude.

By Mr. Mackay:

Q. Now, you reduced that present worth by \$409,000.00, didn't you?

A. Evidently, if that is the difference between them. I never subtracted it, but it must be.

Q. Well, can you tell us what percentage of the expected gross revenue that \$409,000.00 is? In other words, take \$409,000.00 against \$9,000,000.00—I beg your pardon—\$409,000.00 against the value you placed on it, \$4,859,000.00.

A. I don't think that is proper at all, \$409,000.00 tax—no, I mean value off of—oh, I see what you mean. A reduction of \$409,000.00 in value against the \$4,400,000.00 [535] that I spoke about, you want to know what that percentage is?

Mr. Mackay: I will withdraw that. I think that is confusing.

By Mr. Mackay:

Q. You assumed that there would be \$9,000,000.00 total revenue, didn't you?

A. Yes, I am giving that to start with, yes.

Q. And you assumed that out of that \$9,000,-

(Testimony of Walker S. Clute.)

000.00 gross revenue there would be a tax penalty of \$409,000.00, didn't you?

A. Yes, all right, \$409,000.00.

Q. What percentage is that?

A. Isn't that nearly $31\frac{1}{2}$ per cent?

Q. I would think that is about it. Do you think that is a fair penalty for taxes?

A. I had not considered it in that light, that being the tax penalty. I guess it is.

Q. Yes, that is the tax penalty.

A. Yes, but I have got the taxes worked out in another method, so the tax would be \$429,000.00 to a purchaser.

Q. Now, Mr.——

A. No, I mean \$608,000.00 tax.

Q. Now, Mr. Clute, taxes were very much on the increase around this basic date, were they not, income taxes, [536] federal income taxes?

A. Yes, I think they were.

Q. You have done a lot of work on taxes, haven't you?

A. Yes, I think they were, already.

Q. Do you know what the corporate rate was in 1941, federal?

A. Was it about $17\frac{1}{2}$ in 1941?

Q. Don't you think it was around 30?

A. Four years ago? I don't recall.

Q. Do you know that corporations had to pay a franchise tax in California?

A. Surely.

Q. Now, let us just assume that the corporation

(Testimony of Walker S. Clute.)

tax, federal, was around 30 per cent, and let us assume that there was a 3 per cent franchise tax in California. A. All right.

Q. And in 1941 you heard the President say in March that the taxes were going to be greatly increased?

A. Oh, very well, I guess that was accepted at that time, yes.

Q. You knew that the federal government had started drafting men, didn't you, and building up an Army?

A. Surely. All right.

Q. And, of course, as an engineer, you would expect that as a result of that taxes would go up, didn't you? [537]

A. That was the beginning of the war period and I think we knew that taxes were going to go like they did in the previous war, that we would have to pay the taxes. All right.

Q. And you knew, of course, that the government proposed an excess profits tax in 1941—in 1940, I mean?

A. Well, you are recalling details that I cannot answer right now.

Q. You were very familiar with the very high tax that we had in the last war? At that time you worked with the Bureau of Internal Revenue, or shortly after? A. Shortly after.

Q. And that went up to a very high tax, didn't it? A. Yes.

Q. So that on June 5, 1941, the basic date, any

(Testimony of Walker S. Clute.)

reasonable man would have expected that under the conditions prevailing then for the next four or five years the taxes would be greatly increased, isn't that a fact? A. Now——

Q. Isn't that a fact? Can you answer that?

A. Well, yes, all right. They were going to be greatly increased, all right. But I——

Q. Just a moment.

Mr. Melville: Let him explain, Mr. Mackay.

Mr. Mackay: He may have the right to explain if he [538] wants to explain. I am sorry.

A. (Continuing) You were asking me about the income taxes that are going to increase in 1941?

By Mr. Mackay:

Q. Just what you would expect them to do.

A. All right. At the same time, those are the taxes, let us understand, that are going to apply to the buyer of a property after he has taken a static sum of money and exchanged it for an income property, so that he has an income property, and these income taxes are going to apply to him, increasing or not?

Q. Yes.

A. Very well. At the same time we have got to assume that what is called the capital gain tax is going to increase the same rate, it is going to be 30 or 40 per cent.

Q. At that time it was about that much, wasn't it?

A. The seller is faced with a capital gain tax

(Testimony of Walker S. Clute.)

which may or may not be the same as the income tax. He is on the other side of the fence. So, we can argue these taxes up to 95 per cent for both sides if you want to.

Q. I don't want to do that, but you can if you want to.

A. I don't. All right, 30 per cent. We have got them both, the buyer and the seller, facing higher taxes.

Q. That is right. [539]

A. What they are at any date, is that right?

Q. That is right.

A. The capital gain tax ought to almost offset an income tax for the other fellow if they make the rates the same. We know that they don't. The capital gain tax is lower usually due to the time element that he has held the property, and so forth, but you have got your taxes pretty equally balanced there.

Now, then, when we make valuations and I use a straight 10 per cent discount, while that will apply to properties where they can—where taxes are moderate, that will include, in my mind, taxes up to about 12½ per cent, either corporation or individual, whichever you want, on a buyer and a seller. When I give you a value at a 10 per cent figure I think that that value includes any consideration of taxes that may be borne by the buyer or the seller, capital gain on one side and income on the other, and I have brought you to the trading point

(Testimony of Walker S. Clute.)

where the buyer and seller will take a position according to each one's tax status.

Q. Mr. Clue, did you make a determination here as to fair market value——

Mr. Melville: Just a minute. Are you through, Mr. Clute?

The Witness: Yes, all right.

Mr. Mackay: He has had plenty of time. [540]

Mr. Melville: Were you through?

The Witness: No. I wanted to finish my answer.

Mr. Mackay: I don't want to hear his story. I think he has answered the question, your Honor.

The Court: You may proceed with the cross examination. Will you complete your question, Mr. Mackay? The reporter will read it.

(Question read.)

By Mr. Mackay:

Q. ——of the income to be expected in the future as stated in this——

A. Yes.

Q. So you were trying to put a value on future income, were you not? A. That is right.

Q. So, if you are approaching that from a sensible standpoint, as a very fine engineer, you would have to take into consideration the future expected taxes, wouldn't you?

A. Yes, that is what this schedule is for.

Q. O. K. Now, let us assume that the taxes of a corporation that may buy that or may have bought that at that particular time—at the time of the

(Testimony of Walker S. Clute.)

purchase let us assume that the taxes were 30 per cent federal, and let us assume that there was a 3 per cent franchise tax in California——

A. Might I change those? [541]

Q. Can't I ask my question first? Or do you want to talk some more?

The Court: Proceed with your question, and the witness will refrain from answering until it is completed.

Mr. Mackay: Please read my question.

(The question referred to was read.)

By Mr. Mackay:

Q. ——and, furthermore, that the corporate taxes were greatly increased because of the impending war, and even the suggestion by the President was that the taxes would not be less during the next four or five years than, say, 30 per cent federal and 3 per cent state, now will you please tell the court how much, in your opinion, you should penalize that future expected income by those taxes?

A. I will try to. I was going to interpose something a moment ago to say that if you would let me change those rates to 4 per cent state tax and 20 per cent federal tax I could give you some pretty close figures.

Q. Is that what you used?

A. In a computation, illustrative for my own purposes.

Q. You used that to determine the proper

(Testimony of Walker S. Clute.)

amount you should reduce it to get this \$409,000.00 for your present worth value?

A. I will tell you why I did not want to use 4 per cent and 20 per cent nor your 3 per cent and 30 per cent, because [542] if you get your taxes up that high then your stipulation is not worth anything. You have stipulated that this price of oil shall be such and such, \$1.14. If you are going to assume that taxes are going up, you have got to assume that the prices are going up too and your stipulation is gone.

Q. You don't like the stipulation?

A. What?

Q. You don't like the stipulation?

A. You did not stipulate taxes, did you?

The Court: You are arguing, both of you, gentlemen. Let us ask the question and then proceed.

The Witness: Very well.

Mr. Mackay: Will you please read that question again?

(Question read.)

A. No.

By Mr. Mackay:

Q. Well, are you able to tell the court what you would penalize the future estimated income in arriving at the fair market value on account of the tax burden that that income would have to bear?

A. Yes. I assumed that the buyer of this prop-

(Testimony of Walker S. Clute.)

erty, faced with 4 and 20 per cent taxes, and remembering that he gets depletion on cost, would be subject to about \$1,167,782.00 of state and federal taxes, and that would result—— [543]

Q. Give me that figure again, please.

A. \$1,167,782.00, and when you work the present worth of the remaining revenue after that, the value then would be \$4,132,000.00 for the property, using 4 and 20 per cent.

Q. Now, do I understand——

A. But I don't think it is proper to use that when we use that price of oil.

Q. Do I understand, Mr. Clute, that if a buyer paid \$4,450,000.00 for these oil royalties his taxes that you have used there would amount to \$1,167,782.00? A. Yes.

Q. In other words, the \$1,167,782.00 would not go in his pocket but would go to the tax authorities? A. That is right.

Q. That is right? A. That is right.

Q. Now, if you subtract that from \$4,450,000.00, what would be your answer?

A. You will have to subtract the present worth.

Q. Can't you subtract what I am asking you to subtract or do you need a comptometer?

The Court: Let us proceed with the examination of the witness.

A. I have got something subtracted. I have got to [544] take that \$1,167,000.00 away from \$4,859,000.00, and that leaves \$3,691,000.00, but you understand that I do not say that that is your tax penalty

(Testimony of Walker S. Clute.)

because you should take the present worth of \$1,167,00.00, which I presume would be about \$600,000.00, away from the \$4,859,000.00. Shouldn't you? Your taxes are only paid out by years, and it is like a cost, so you take the present worth of that cost.

The Court: Any further cross examination of the witness?

Mr. Mackay: Yes, your Honor.

By Mr. Mackay:

Q. Now, Mr. Clute, what do you allow that 10 per cent for—what is that 10 per cent discount which you allowed there before you took off the taxes?

A. That is a discount factor which in my opinion includes for ordinary properties a fair return of interest on your investment plus nominal taxes, and by nominal taxes I will specify up to about 12½ per cent, because this runs along through the years in times when taxes are up to about 12½ per cent, state and federal together, and whether it is corporation or individual, about 12½. All right. If I use the 10 per cent factor, that is taking care of taxes up to about 12½ per cent. Then if I want to assume that taxes will be 4 and 10, the state 4 and federal 10 more, which amounts to about 13 per cent more, then I have got [545] 12½ and 13, and I have got about 20 per cent taxes, and I feel that is about all that a business or property can work under, and if I should allow any higher rates

(Testimony of Walker S. Clute.)

of taxes than that I cannot do it with an oil property producing this revenue, so I have allowed all the taxes I can in this first 10 per cent plus 4 and 10 per cent more.

Q. Where do the hazards come in there?

A. Your hazards have been mostly—there is a little business hazard in your 10 per cent but it has mostly been taken out in the estimate of oil.

Q. Tell us, Mr. Clute, what goes in the 10 per cent?

A. Just a reasonable interest return, and that will give a value that is so sufficiently close to the fair market value that it can very well absorb taxes, buyer's and seller's taxes.

Q. All right. How much do you allow for interest?

A. What? Oh. You are going to split that 10 per cent up.

Q. I want you to split it up.

A. I can't split it up any closer than that. I just have a feeling it includes the two.

Q. What kind of hazards go into that, Mr. Clute?

A. I will say not the hazards of production because I have taken those out when I have made my estimate.

Q. What estimate? [546]

A. The oil reserves and future production.

Q. I know, but this is already made for you. You started out with the estimated oil reserves.

A. All right, then there is no hazard—you asked

(Testimony of Walker S. Clute.)

what hazards were in it. There is no more hazard in this 10 per cent that I can put my finger on.

Q. You mean there is no hazard in the 10 per cent?

A. I will give up at that point. I don't know how much hazard there is in there. Nobody knows.

Q. What do you allow for the use of money in that 10 per cent? A. For use of money?

Q. Yes. A. You are thinking now of——

Q. Don't you understand what I asked you?

A. For use of money? I think you mean the money that I am going to have returned to me for reinvestment.

Q. Oh, no, Mr. Clute.

A. Well—for use of money? Oh, I understand now what you mean? Borrowed money? What interest I would have to pay on borrowed money? Is that what you mean?

Q. What part of the 10 per cent represents interest, if any, for the use of money?

A. Oh, I see. I don't know.

Q. You don't know? [547]

A. No, I don't.

Q. You have not given that any thought? Well, what part represents taxes?

A. In my mind about—I think if I went to work on that problem I would probably assume that about 4 per cent represented taxes and 6 per cent the money interest.

Q. Do you mean to tell me there is no hazard

(Testimony of Walker S. Clute.)

in getting that income? Don't you understand what I mean?

A. Yes, of course I do. I have to think that over.

Q. I don't want to rush you, I am sure. You can't answer that question, can you, Mr. Witness?

A. I can't answer it very well.

Q. Do you mean to tell the Court here that a buyer would be willing to risk his money in this kind of a purchase on a 6 per cent return—to get his money back plus 6 per cent? Is that what you mean? That must be so.

A. No. No, I don't.

Q. You think a man would want a little more return? A. Yes, I do.

Q. Why did you say a moment ago that you thought 6 per cent would be the interest?

A. You say, would he buy this property here? Well, sir, I think he would buy another property. We value virtually none of them at 10 per cent and we place——

Q. Where do you—— [548]

A. Remember, that is a long life property.

Q. Anyway, you don't mean to tell the court that a person would be willing to put their money in here and just get back 6 per cent interest plus their capital, do you?

A. I think he would want more.

Q. Yes. How much more?

A. Well, he would certainly want the full 10 per cent if he could.

(Testimony of Walker S. Clute.)

Q. Just for his interest alone?

A. Yes, I believe so.

Q. But you have figured it on the theory that a man would be satisfied to get his money back plus 6 per cent, haven't you?

A. Yes. So, now, you have got the whole 10 per cent taken up with the use of money. Now, where are the taxes?

Q. Now you think the interest alone ought to be 10 per cent, don't you?

A. Yes, I do think that way.

Q. Now, a man would have to get his money and pay his taxes too, wouldn't he? What?

A. Get his money back and pay his taxes too, yes.

Q. Where is he going to get the money to pay his taxes if you merely discount it 10 per cent?

The Court: Do you understand the question, Mr. Witness? [549]

The Witness: Yes, I do.

A. Naturally, I only allowed the 13.6 more per cent of taxes, that is, 13.6 per cent——

By Mr. Mackay:

Q. That is not enough to allow on the income that will have a tax penalty of 30 per cent or more, Mr. Clute? A. Well, that is——

Q. Can you answer yes or no?

A. I am not going to answer yes or no because this property is going on for the next 20 years, and do we know the tax rates are going to be 30 per cent for all the life of this property? It might not be

(Testimony of Walker S. Clute.)

at all. It may be in 1941, 1942, and up until 1948, but they are going to change. They were going up at that time, but in the foreseeable future they are going to be pretty high but maybe not 30 per cent, so I don't think your assumption is entirely correct.

Q. Well, do you think a willing buyer would take a chance on June 5, 1941, of the taxes going down?

A. Oh, not going down below that point, no. Of course not.

Q. As a matter of fact, you know that most people who were capable and willing to buy anything like this were pretty well scared of the national debt at that time, were they not?

A. Probably so. [550]

Q. And there could not be much hope——

A. Remember also they hoped for an additional price of oil, whether they got it or not. That was ahead of him just as taxes were.

Q. Yes. Now, if you allow only 6 per cent, if you allow 10 per cent there in your discount for interest and you do not allow enough for the man's taxes, how do you figure the prospective buyer will ever get any profit out of it, Mr. Clute?

A. It is clear on the arithmetic of it that he could not.

Q. He could not get any profit on it, could he?

A. No.

Mr. Mackay: That is all.

(Testimony of Walker S. Clute.)

Redirect Examination

By Mr. Melville:

Q. Mr. Clute, do you consider yourself an expert on taxes?

A. I have been told that I am not.

Q. Do you consider that taxes are a charge against income or a charge against fair market value?

A. They are a charge against income, but when you write them into a valuation they are like any other cost of which you may ascertain the present worth, and then the present worth is a charge against value. [551]

Q. Mr. Clute, you have clients, don't you?

A. Yes.

Q. If you were willing to perform a specific service for a client in a given year, let us take 1941, to do a certain job for a certain client in 1941 for, let us say, \$5,000.00, then along came 1942 and the taxes had gone up, doubled, would you charge less to do that same job in 1942 than you did in 1941, taking into consideration the tax problem?

A. No, naturally no.

Q. Would you charge more?

A. If I were entitled to it, depending on my contact with my client. In a commercial way I would be inclined to charge more, yes.

Q. Would you consider that your services were entitled to a certain value and your tax problem was your own business?

(Testimony of Walker S. Clute.)

A. Yes. I have got to fall back on my relations with the client there, but if I were in business absolutely buying and selling for a measurable time I would just have to charge more when my taxes went up. They are a cost against my income.

Q. You would have to charge more for your services because the taxes were higher than you would have to charge for your service if the taxes were lower? A. Yes. [552]

Q. Now, if you were selling something rather than your services, selling a commodity like oil, and you had a tax problem where your taxes were greater, you are the prospective seller, if you make any gain on the sale of this oil property now you are going to have to pay higher taxes, would there in your opinion be any reason for selling it lower because the taxes were higher?

A. No, it would have to sell for a higher price.

Q. That is, from the seller's standpoint?

A. From the seller's standpoint. Did you mean if I was selling oil or a property as a lump sum so the capital gain takes hold?

Q. Yes.

A. I would want a higher price then to cover my taxes.

Q. All right, then, if the very same willing buyer that Mr. Mackay has been talking about takes all the discounts for taxes and the very same willing seller adds a lot of things because of taxes, would they ever get together and consummate a sale, in your opinion, unless they both disregarded taxes?

(Testimony of Walker S. Clute.)

A. They would go farther apart, yes, one would go one way and one the other.

Q. Unless they disregarded taxes they would not ever get together, would they? Mr. Clute, let us assume that a given stock, let us take Chesapeake & Ohio—sells on the [553] New York Stock Exchange today for 58 and there are any number of sales in it, 1,000 or 2,000 or 10,000, does that in your opinion establish the fair market value of that stock? A. On the Exchange? Yes, indeed.

Q. All right. Now, suppose that a charwoman, who is in the very lowest income tax bracket, sold 100 shares today of C & O at 58 and that that particular 100 shares was bought by J. Pierpont Morgan, who is probably in the highest tax bracket, does the fact that Mr. Morgan would have a tremendous tax problem to concern himself with and the charwoman had practically none, change the fact that \$58.00 is the fair market price of that stock?

A. Obviously no. There are a million other shares which set that value for some reason or other between them.

Q. Now, Mr. Clute, you followed in making your valuation in this case a method that you have followed on the basis of your years of experience?

A. Right.

Q. Is that the same method that you followed in valuing the—what was that sale?

A. The O'Day.

Q. —the O'Day property?

A. Yes.

(Testimony of Walker S. Clute.)

Q. Who was the buyer in that case?

A. The Union Oil Company and Barnesdale Oil Company [554] together.

Q. They were the buyers? A. Right.

Q. Were they also the lessees?

A. Yes, they were.

Q. They were, then, well acquainted with the property? A. Yes, indeed.

Q. Is it a safe assumption that they had a tax problem? A. Of course.

Q. Who was the seller?

A. The O'Day Estate, administered by the Citizens National Bank.

Q. And the Estate, you presumed, had a tax problem? A. I do, yes.

Q. Did you take into consideration taxes just as much, no more and no less, in that appraisal in the O'Day Estate case as you did in this case?

Mr. Mackay: If your Honor please, I object.

The Court: A lot of this is already in the record, so if you are not cross examining your witness I am reluctant to stop you.

Mr. Melville: I will withdraw the question.

The Court: Very well.

By Mr. Melville:

Q. What was the date of that O'Day sale? What year? [555] A. May 3, 1945.

Q. Were the taxes in 1945 more than they were in 1941?

(Testimony of Walker S. Clute.)

Mr. Mackay: Well, if your Honor please, I suppose we all know that.

A. Yes, I think they were; yes, I do.

By Mr. Melville:

Q. Now, did you take into consideration your method of appraisal in the O'Day case the tax problem of the oil companies that bought it or the O'Day Estate that was selling it?

Mr. Mackay: If your Honor please, I object to that. It is not really proper on redirect. It has been gone into and I think it is beyond the pale of redirect examination.

The Court: Probably, but we will permit him to answer this question. You may answer.

The Witness: Please read it again.

(Question read.)

A. I gave consideration to taxes and just concluded that whatever taxes that might be applicable to it—there might have been a balance between one side and the other but they were encompassed within that 10 per cent factor that I used.

By Mr. Melville:

Q. And was the subsequent sale—did the subsequent sale of that property in your opinion confirm the accuracy of your method of valuation? [556]

Mr. Mackay: I object to that, if your Honor please. It is not proper redirect.

The Court: Overruled. I think he has already answered that.

(Testimony of Walker S. Clute.)

Mr. Mackay: Several times, your Honor, I think.

The Court: Do you recollect the question, Mr. Clute?

By Mr. Melville:

Q. You may answer it, Mr. Clute.

A. In my opinion it confirmed the accuracy of my appraisal.

Mr. Melville: No more questions.

Mr. Mackay: That is all, Mr. Clute.

(Witness excused.)

The Court: We will suspend for a brief recess.

(Short recess.)

Mr. Melville: Mr. Corby, will you please take the stand?

GRANT W. CORBY,

called as a witness by and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: Your name for the record, please?

The Witness: Grant W. Corby.

By Mr. Melville:

Q. Mr. Corby, will you please state your educational background?

(Testimony of Grant W. Corby.)

A. I graduated from Stanford in 1922, took a Master's Degree in 1923.

Q. What subject? What course?

A. Geology and mining and valuation.

Q. And have you had experience in the oil business? A. Yes, I have.

Q. How much? A. Well, since 1923.

Q. And what have you been doing in the oil business since 1923?

A. Well, I have been doing field geology exploration, geology valuation, purchasing royalties, consulting work, consulting engineering.

Q. Have you been furnished with the stipulated figures on probable future royalties from the developed oil reserves of the Dominguez Estate Company after June 5, 1941? A. I have.

Q. Are these the exhibits that you were shown?

A. (After examining). They are.

Q. Have you formed an opinion, based upon those exhibits and figures, as to the value of the royalty assets of [558] the Dominguez Estate Company as of June 5, 1941? A. Yes, I have.

Q. What is that opinion?

A. My opinion is \$4,330,255.00.

Q. Will you please explain how you arrived at that?

A. Yes. It was a short method that I used and it consisted of taking the total production according to the figures you supplied to me and cutting the value in half, and in addition to that I worked out the return, using a 10 per cent interest rate,

(Testimony of Grant W. Corby.)

and worked out a pay-out, and it paid out in around 17 years.

Q. And what figure did you take 50 per cent of?

A. \$8,660,511.00, which was the figure supplied on this stipulated sheet.

Q. And what exhibit is that on?

A. That is on Exhibit 2 here.

Q. Read the whole thing.

A. Joint Exhibit 2-K (2).

Q. Will you read it again? A. Is that 11?

Q. That is 11.

A. I am sorry. It is Joint Exhibit 11-K (2).

Q. Is that method of valuation one that is recognized in the oil industry? A. Yes, it is. [559]

Q. Is it the method on which oil royalties are bought and sold? A. Yes, it is.

Mr. Melville: You may cross examine.

Cross Examination

By Mr. Mackay:

Q. Did I understand you to say that you took the total estimated production and divided it by half? A. Yes.

The Witness: Is that an estimated production that you supplied me on those figures?

By Mr. Mackay:

Q. Isn't it? Did you read the stipulation?

A. Yes, I read the stipulation.

Q. Will you please refer to the stipulation—where is it?

(Testimony of Grant W. Corby.)

The Court: Here is the original stipulation, if you wish it, Mr. Mackay (handing).

Mr. Mackay: Thank you.

By Mr. Mackay:

Q. I call your attention to the stipulation, paragraph (k) on page 5:

“Joint Exhibit 11-K (1) is the estimated amount, in barrels of oil, of ultimate probable future production from known oil reserves of all oil properties owned [560] by Dominguez Estate Company on June 5, 1941, together with the royalty share of Dominguez Estate Company therein. The estimated probable future production by calendar years is based upon the assumption that all wells being produced on June 5, 1941, would continue to be produced to the full indicated capacity of the formation to yield the oil, and, further, that each probable productive location of said known oil reserves would be developed and produced to its full indicated capacity in accord with its probable development program.” [561]

You understand that, don't you?

A. I understand it.

Q. That that is merely an estimate?

A. That is an estimate, yes.

Q. With respect to the second paragraph, it reads just about the same with respect to the rate

(Testimony of Grant W. Corby.)

of production? You understand that to be merely an estimate, don't you? A. I do, yes.

Q. So, you took the estimated total barrels and you divided it by half? A. That is right.

Q. And then what did you do?

A. Used that as the present day value.

Q. Did you use that as the present——

Mr. Melville: I didn't hear that question. Did you say "barrels" or "dollars"?

Mr. Mackay: I said "barrels". He said "half." I was just going to clear that up.

The Witness: This is in dollars.

By Mr. Mackay:

Q. I beg your pardon?

A. I have never seen any records of barrels. I have seen dollars.

Q. You have not seen any records of barrels at all? So, then, you have taken the estimated gross receipts, [562] A. That is right.

Q. And you divided those in half?

A. That is right.

Q. And is that your fair market value?

A. That is the market value that I arrived at, yes.

Q. What did you allow for income taxes?

A. The other 50 per cent.

Q. The other 50 per cent? A. Yes.

Q. What profit is there in there for a purchaser, then, Mr. Corby?

A. Well, there is profit in there, according to

(Testimony of Grant W. Corby.)

my valuation, by deducting your total income—cutting it in half, there is enough profit there to pay your taxes and a return on your money and also investment on your principal.

Q. How much?

A. I worked this—I took these figures here of \$4,330,225.00, and worked out a pay-out in years and deducted 10 per cent from that, from each year's pay-out, and returned the rest back to capital, and that worked out to be a 16½ or 17-year pay-out.

Q. So, you just assumed that a person would be willing to put his money in that and get a 10 per cent return, is that right?

A. Yes, gross.

Q. Gross? What would be the net income?

A. Will you please state your question a little more clearly? You mean a 10 per cent net return?

Q. What do you mean?

A. You are asking the questions.

Q. O.K. What went into that 10 per cent? Why did you use 10 per cent?

A. I think that 10 per cent should take care of taxes and interest.

Q. Nothing else?

A. No, because already you have got a 50 per cent deduction.

Q. I though you said you reduced it 50 per cent because of taxes?

A. To bring it to present day value because of interest and taxes, and I took the pay-out each month and took 10 per cent of that and returned

(Testimony of Grant W. Corby.)

the balance to principal. On that basis it worked out to be a 16½-year pay-out, practically 17 years.

Q. What profit did you figure in there?

A. The profits in your 10 per cent.

Q. So, all the profits would be in the 10 per cent?

A. Where else would it be?

Q. I am asking you.

A. I put it in the 10 per cent. [564]

Q. That is what I mean. You put all the profit in the 10 per cent? A. That is right.

Q. So, it is your opinion that a willing buyer would be willing to invest his money and to have received a profit of 10 per cent, is that right?

A. I think so, yes.

Q. I beg pardon? A. Yes.

Q. Well, how about taxes, then?

A. What do you mean, how about taxes?

Q. Well, the man has to get that 10 per cent back, at least, and he would have to pay taxes, wouldn't he? A. It depends on the purchaser.

Q. Who in America does not have to pay taxes, Mr. Corby?

A. It depends on a number of things. If it is a corporation, one corporation might buy these royalties that is in the hole.

Q. In the hole? A. Yes.

Q. Wouldn't they have to pay taxes?

A. Not if they were in the hole, if they had a deficit.

Q. You mean to say that a corporation having a deficit——

(Testimony of Grant W. Corby.)

A. If they bought these royalties and threw them into [565] their source of income it would be worth more to them than it would be to John D. Rockefeller.

Q. Let us assume you found a willing buyer who was operating in a deficit and that he purchased that for your estimated fair market value of \$4,330,000.00; now, is it your opinion that that purchaser could get all of that money back without paying any taxes, including the 10 per cent profit?

A. It depends on the circumstances of the purchaser. You say he is in debt.

Q. You said he was in debt. I didn't.

The Court: You are arguing, gentlemen. Let us proceed with the question and answer form, please.

By Mr. Mackay:

Q. Do you think that a corporation with a big deficit like that could pay \$4,330,000.00?

A. Yes, I think one with a deficit could pay it and make money on it. That is my opinion.

Q. But it is still your opinion that a willing purchaser, able to buy, would be willing to put his money—to put down \$4,330,000.00 and get his capital back in 17 years and 10 per cent interest, is that right? A. Yes.

Q. Is that right? A. That is right. [566]

Q. And without any allowance for hazards?

A. You have got an allowance for hazards right there.

(Testimony of Grant W. Corby.)

Q. Mr. Corby, are you familiar with the earthquake hazard in California? A. Yes.

Q. Do you know, as a matter of fact, that the Havens-Wright wells, which are not very far from these—that many of those were completely severed and made non-useful because of an earthquake? You know that, don't you?

A. I have heard it.

Q. You heard it? A. Yes.

Q. You also have known that in Santa Fe Springs, which is just a little bit east of there, in the same general territory, that the same condition happened, don't you?

A. Yes, I believe the production was altered in some of the wells.

Q. Don't you think a willing purchaser might take into consideration the earthquake hazard?

A. Yes, I think so, and I think also a willing purchaser would take into consideration the possibilities of the deeper sands too, which we have not talked about here.

Q. At Dominguez? A. Yes, in 1941.

Q. Have you ever been on the property?

A. Yes.

Q. When? [567]

A. Well I was across the property a few months ago.

Q. When? A. April.

Q. April? A. Yes.

Q. Which property did you go on?

(Testimony of Grant W. Corby.)

A. I simply went across the Dominguez field.

Q. In an automobile? A. Yes.

Q. You did not stop? A. No.

Q. And you saw all the working conditions and are able to pass an opinion on them?

A. Well, I was not asked to pass an opinion on those working conditions, and I have not been asked here.

Q. Did you make any inquiry here as to the average daily production of these wells?

A. I did not.

Q. Wouldn't you consider that that information would be important in determining the fair market value?

Mr. Melville: If your Honor please, I don't want to curtail the cross examination, but it seems to me that after we have spent weeks, and in fact months, agreeing upon stipulated facts in order that we could avoid calling witnesses who would have to go into the oil reserves and all these [568] other factors, it seems unfair for counsel to ask this witness if he did not consider facts which were not in the stipulation. In view of the fact that the witness has stated he considered all the factors necessary to formulate an opinion, if he is qualified to formulate an opinion and has all the factors necessary, he is entitled to express it. If counsel did not think he was qualified he should have objected at the time.

Mr. Mackay: If your Honor please, I think the

(Testimony of Grant W. Corby.)

witness is the one that brought the deeper zones in here.

The Court: I think I will sustain the objection as not proper cross examination. You may proceed.

By Mr. Mackay:

Q. But you have made no examination of the property, have you?

Mr. Melville: When?

Mr. Mackay: At any time.

The Witness: Yes.

By Mr. Mackay:

Q. When?

A. In the early stages of the—just about the time of the discovery well in the Dominguez field.

Q. That was about 1923, wasn't it?

A. Yes.

Q. But not since that time?

A. Geological examinations? [569]

Q. Yes. A. Yes.

Q. When?

A. When I was employed by the Marland Oil Company, we were attempting to get a lease up there.

Q. When was that?

A. It was about the time the Union—you will have to supply that date. I don't know.

Q. Do you know how many zones there are in that field? A. About eight.

(Testimony of Grant W. Corby.)

Q. Do you know the depths of the deepest wells?

Mr. Melville: I object, your Honor. That is not material to the issue in this case.

Mr. Mackay: If your Honor please——

The Court: He may answer the question. Objection overruled.

The Witness: I can't remember the depth of the deepest. I think they are around 8000 or 9000, but I do not know that entire section has not been penetrated.

By Mr. Mackay:

Q. How do you know that, Mr. Corby?

A. There has been no well, according to my knowledge, that has ever cored the schist.

The Court: I didn't get that. What did he say?

(The answer was read.) [570]

The Court: That is an expression that is not in my vocabulary.

The Witness: May I explain it?

The Court: Yes. It is not in my vocabulary.

The Witness: The schist has been recognized as the basement rocks in the Los Angeles Basin in which there is no production. As an example, in the Venice field immediately above the schist there is a productive zone and below that is considered not to be productive. It is what we call the basement rocks.

The Court: You express the whole thing in three words, "core the schist"?

The Witness: Schist or basement rocks.

(Testimony of Grant W. Corby.)

The Court: That is a new word, a new expression.

By Mr. Mackay:

Q. Don't you know, as a matter of fact, that Well No. 79, drilled in 1940, pierced that zone, went below the schist?

A. I don't know definitely that it did, no. I think there has been some discussion on that geologically.

Q. Is it not a fact that Well No. 135 on the Reyes lease was drilled into the schist?

A. Not to my knowledge.

Mr. Melville: What date?

Mr. Mackay: That is all, your Honor.

The Court: Any redirect? [571]

Mr. Melville: No questions.

The Court: Let me ask the witness—counsel, you may wish to clear it up. I notice he used the figure of \$8,666,000.00, which does not include the estimated income after 1965, is that correct, the basic calculation?

Mr. Melville: That is correct.

The Court: Do you know why he did that, either of you?

Mr. Melville: Well, I think I can explain it as a lawyer but not as an engineer.

The Court: I don't wish to interfere with your trial of the case. It is just a query that occurred to me, that is all. You can do as you please about clearing it up.

(Testimony of Grant W. Corby.)

Mr. Melville: Your Honor, when it comes to dealing with oil in the ground, there is nobody that can say positively how much oil is in any given well. It is just impossible. God alone knows.

Mr. Mackay: I will stipulate that.

Mr. Melville: Now, then, the engineers make various appraisals, and we had various appraisals in this case, the Government's appraisals that there was so much oil down there, and the taxpayer's. Is this on the record?

The Court: It may be if you desire.

Mr. Mackay: I think it ought to be.

Mr. Melville: I will be glad to leave it on the record. [572]

The Court: So far it has been.

Mr. Melville: If you disagree with anything I say you can stop me.

Mr. Mackay: I don't believe I can disagree with you, Colonel.

Mr. Melville: Thank you. The Government said in appraisals what they thought the oil reserves were, and the taxpayer likewise had appraisals, and we realized that this law suit might take weeks or months if we each had to bring in engineers who appraised these oil properties and each engineer would have to state his valuation as to the oil reserves. Probably each engineer would have a different estimate of the rate of production and probably each engineer would have a different estimate of the future price of oil. So, if each side had five engineers, a total of ten, and each one had

(Testimony of Grant W. Corby.)

a different opinion, we would have a total of one thousand possible answers from which your Honor would have to choose the right one. So, in asking the hypothetical questions of our witnesses on the valuation it was conceivable that each side would have to ask one thousand hypothetical questions in order to cover all possibilities. Therefore, recognizing our problem and your Honor's problem, we got together and compromised, the Government came down and the taxpayer came up, and we agreed on so many barrels in the ground. This eliminated any engineering testimony as to how much oil was in reserve. [573]

We also agreed on the probable future rate of production and thus we eliminated any necessity for engineering or geological testimony as to that factor. We also agreed on the third, and only conditional, factor, in order to arrive at the future royalty income, namely, the future price of oil.

Having agreed on all those, we reduced our agreements to a stipulation of probable future royalty income.

Mr. Mackay: Estimated.

Mr. Melville: Estimated. Now, the word "estimated," your Honor, was used because we recognized, as I previously stated, that God alone knows what the answer is as to how much oil there is down there, so we did not want to state it as a fact. It would be a presumption on the Almighty for us to state, as a fact; how much oil is in the ground, we don't know, but that is the best estimate

(Testimony of Grant W. Corby.)

that we could make. It amounts to a compromise on the side of both the Government and the taxpayer, and when we came into Court—and I am speaking now for myself and I hope Mr. Mackay agrees with me—when we came into Court we thought the figures were agreed upon. If they are not agreed upon, I don't know why we spent the time working out the stipulations.

The Court: Well, I have nothing but the kindest feeling for counsel on both sides for having gotten so nearly together. I don't want you to misunderstand anything I might have said. I merely asked why the witness did not use the [574] \$9,000,000.00 figure, which Mr. Paine and some of the other witnesses had used, instead of the \$8,666,000.00.

Mr. Melville: Well, I am frank to let the witness answer that, but I think that the Government is willing to recognize that the amount of oil that is left in the ground after 1965 can be charged off to a safety factor.

The Court: Very well. Is that all from this witness, gentlemen?

Mr. Mackay: Yes. I merely want to say that the stipulation speaks for itself.

(Witness excused.)

Mr. Melville: Your Honor, in order to clarify three of the exhibits, 1-A, 2-B and 3-C——

The Court: Let us have them, if you will, please.

(The papers were handed to the Court.)

The Court: You may proceed, Mr. Melville.

Mr. Melville: It is hereby stipulated and agreed between the parties that as to Joint Exhibits 1-A, 2-B, and 3-C, that the aggregate liability stipulated to in said exhibits include 5/12ths of the Federal Income in California Franchise Taxes, and the property taxes for the full year 1941, which were a lien not yet payable.

The Court: Well, see if I understand what you are stating there correctly. You have under the column of book value listed current liabilities of \$239,000.00 odd, and then [575] you have listed the same current liabilities under the stipulated fair market value, that \$292,000.00 odd. So, what you mean to say, if I am correct—I am only asking—is that the \$292,000.00 odd does include the 5/12ths of the taxes. Is that what that amounts to?

Mr. Melville: Are you referring to the figures, your Honor, under fair market value?

The Court: Yes, in Joint Exhibit No. 1, stipulated for fair market value.

Mr. Melville: What it amounts to, your Honor, is that, that the particular corporations that we are dealing with in this case—I believe this correct, Mr. Arnold—are on the cash receipts and disbursement basis.

Mr. Arnold: That is correct.

Mr. Melville: And Mr. Arnold asked the Government if we would agree to let him include the income taxes for the entire year 1941 when we were stipulating as to the figures as of May 31, 1941. Now, it so happens that the figures that are in the stipulation do not agree with the Revenue Agent's

reports and the Government's data. In order to reconcile the two, we wanted to stipulate that as to real state taxes the taxes for the entire year are in there, although the stipulation is only supposed to go as far as May 31, 1941, and that the Federal Income Taxes are in there to the extent of 5/12ths of the year, which is correct. The justification [576] for putting the entire 1941 real estate taxes in, your Honor, is because under California law they become a lien on the property prior to May 31, 1941.

The Court: Very well. Thank you, gentlemen. Off the record.

(Discussion off the record.)

The Court: On the record. We will suspend in the trial of the Caldwell and the Cotton cases until 9:30 tomorrow morning.

(Whereupon, at 5:05 p. m., a recess was taken until 9:30 a. m., Friday, October 12, 1945.)

PROCEEDINGS

October 12, 1945—9:30 a. m.

The Clerk: Docket No. 2257, Victoria L. Cotton, and 7583, Virginia Caldwell.

Mr. Melville: Your Honor, one of the first things I would like to do this morning is to clear up the two points with respect to the proceedings yesterday. The first is that I would like the record to

show that Mr. Webb, who appeared here rather reluctantly, did so under subpoena. Will you so stipulate, Mr. Mackay?

Mr. Mackay: I will accept your word. Would he be available for a little further questioning?

The Court: Off the record.

(Discussion off the record.)

Mr. Melville: Will you stipulate that Mr. Webb appeared here under subpoena?

Mr. Mackay: I will take your word for it.

Mr. Melville: Will you take a look at the official subpoena and admit it or shall I have to put it in evidence?

Mr. Mackay: Surely, I will stipulate it, Colonel.

Mr. Melville: The other point I would like to clear up with respect to Mr. Webb's testimony, your Honor, is that at the time I was unable to find attached to the stipulation any facts with respect to previous production in barrels. I thought at the time that there was evidence to that effect in, but I could not find it, so I stated on the record that [582] apparently it was not in. I find, however, that I was wrong then and that in fact Petitioner's Exhibit 23 gives the royalty barrels by leases by years for the Dominguez Estate Company.

Mr. Mackay: I knew that all the time. Is it possible to get Mr. Webb back?

Mr. Melville: Off the record, please.

The Court: Off the record.

(Discussion off the record.)

The Court: Then the answer to counsel's question is that Mr. Webb will not at this time be available for further cross examination?

Mr. Melville: That is my best, honest belief, your Honor.

The Court: Very well. Off the record.

(Discussion off the record.)

The Court: On the record.

Mr. Melville: Your Honor, I have in my hand the minute book of the Dominguez Estate Company which contains the minutes of a regular meeting of the board of directors dated August 13, 1941, and I offer at this time to read into the record a short paragraph from those minutes setting forth the views of the chairman, Mr. H. H. Cotton, with respect to how to arrive at the value of the Dominguez Estate Company's stock. Any objection?

Mr. Mackay: If your Honor please, I object to that [583] as incompetent, irrelevant and immaterial. I will admit for the purpose of the record that that is the minute book which counsel now has in his hand, but certainly, if your Honor please, what may have been said in the minutes of the Dominguez Estate Company can have no bearing on this case here. We are now valuing the stock of Virginia Caldwell and Victoria Cotton that they gave away and it has no place here and it is incompetent, irrelevant and immaterial. I say that I admit it is the minute book of the company, but I see no purpose at all and I think it is entirely

incompetent and irrelevant for the purpose offered.

Mr. Melville: I will admit, your Honor, that I have not laid a very good foundation for my offer, but I was trying to spare Mr. Cotton, an elderly gentleman, from taking the stand.

Mr. Mackay: I will admit it is the minutes.

Mr. Melville: If I have to lay a real foundation——

The Court: I think I am prepared to rule. We will receive it. If it has no materiality we will ignore it. What are you doing? You are reading only a portion of it?

Mr. Mackay: That is right.

The Court: Does counsel for the Petitioner desire that it all be in evidence?

Mr. Mackay: No, not so far as that one is concerned. Go ahead. [582]

The Court: Well, we will hear the excerpt. It may be read into the record.

Mr. Melville: Your Honor, before I start reading, I would like to clear up the matter of it being an excerpt. At this meeting they did certain things and I am reading everything with respect to the subject matter that is contained in this paragraph. I am not reading the part of the minutes that said who was present and that they read the minutes of the previous meeting, and that they voted dividends, and so forth, but everything relating to the subject matter of this paragraph is being read, your Honor:

“The chairman, Mr. H. H. Cotton, then brought up the matter of an appraisal on the

Dominguez Estate Company stock, stating that in his opinion he felt that an appraisal of the assets should be made of the Dominguez Estate Company to determine the present value of its stock. After a short discussion, a motion was made by Mr. Edward A. Carson, seconded by Mr. David V. Carson, and unanimously carried, authorizing the officers to select suitable appraisers to make this appraisal."

Your Honor, I have in my hands a copy of the report to the stockholders of the Dominguez Estate Company, dated March 25, 1941, rendered by H. H. Cotton, the president, and I offer in evidence the entire report. [585]

Mr. Mackay: I think I have a copy of it here.

Mr. Melville: Do you have two copies?

Mr. Mackay: That is all I have but we may be able to get another.

Mr. Melville: In addition to the copy that is attached to the minutes of the stockholders' meeting, Mr. Mackay has very kindly given me an extra copy of the report to the stockholders referred to. I offer it in evidence with the request that I be permitted to withdraw it and make a certified copy for my own use and return the original to the Clerk.

The Court: If there is no objection, the document may be handed to the Clerk and marked Respondent's Exhibit BB, and it will be received in evidence. Leave will be given to withdraw it for the purpose of making copies.

(The report referred to was marked and re-

ceived in evidence as Respondent's Exhibit BB.)

[Respondent's Exhibit BB set out in full in Book of Exhibits.]

Mr. Melville: Your Honor. I have in my possession the minute book of the Dominguez Estate Company, containing the minutes of the stockholders' meeting held on April 10, 1940, attached to which is a report to the stockholders, dated March 28, 1940, rendered by H. H. Cotton, president, and there are three excerpts from that which I would like to read, although I have no objection if the entire report goes in.

Mr. Mackay: I am sorry. I have not seen it.

The Court: We may be off the record for a moment. [586]

(Discussion off the record.)

The Court: Are you ready to proceed, gentlemen?

Mr. Melville: I am, your Honor.

Mr. Mackay: If your Honor please, we should like to object to this. This is a report to stockholders in 1940, and it would seem to me it would have no bearing upon the issue here. It could not have any bearing upon the values, and we object to it for that reason. Besides, if your Honor please, it is a statement by the officers of the company, it is true, but what value does it have to go back there in 1940 when we had conditions—until, if your Honor please, they show the conditions in 1940 they

have not laid the proper foundation. If they are trying to make a comparison of conditions in 1940 and 1941 by these minutes or by these inferences or whatever they are trying to put in, they must first under the rules of law lay a sufficient foundation so they compare like things and not apples with peanuts, and until that foundation is laid, if your Honor please, I think it is entirely incompetent, irrelevant, and immaterial.

The Court: What is your theory as to the materiality of competency of this particular evidence, Mr. Melville?

Mr. Melville: Simply this, your Honor, when Mr. Cotton rendered a report to the stockholders in 1940 he made this statement——

The Court: Now, without reading, just tell me what [587] is your theory as to the competency of the evidence. How is it going to connect with the valuation that we have a year or so later?

Mr. Melville: My theory is, your Honor, and I am prepared to prove it the hard way if necessary, that the directors, stockholders and officers of this company had constantly over a period of years from 1936 to 1941, inclusive, placed a value of \$1000.00 a share on Dominguez Estate Company stock, and I can prove it if I can get in this minute, that is, I can make one step toward that proof.

The Court: Well, you have hardly answered the question. You are valuing, or we are attempting to value, in this case the stock of this company as of June 5, 1941. Now, as to a value placed upon the stock by officers of the corporation at some earlier

date, it would probably be hearsay and be mere speculation or opinion of the officers. They may have been entirely too optimistic or they may have been entirely too pessimistic. I fail to see where it has a great deal of materiality, assuming that there is any competency at all, although I am reluctant to exclude it from evidence if you think there is some real connection that can be made.

Mr. Melville: Your Honor, I am prepared to show that there have been sales of this stock, not to outside interests but among themselves, in the family group, of the stocks involved in this case, not a great many perhaps, not [588] more than 16 or 17 sales, over a period of several years, but those sales will establish that the value placed on this stock by the people themselves in round dollars of one thousand a share. Now, I appreciate that if I take any one sale and try to put it in evidence my opposition will object on the ground that it is an isolated sale, and I must admit that it would be an isolated sale, but when you take them altogether and they represent all of the sales for a five-year period preceding our basic date, it seems to me it is material.

Mr. Mackay: May I make an observation, your Honor? In 1941, the evidence shows, the Dow Jones averages were 118. I think it will show also that back in 1936 they were something like 196. Conditions were entirely different. Until counsel is prepared to show conditions exactly the same at both dates, it does seem to me that it is going far afield on the question of valuation. We must not overlook

the fact too that according to the stipulations since 1936 we have shown the revenue, a tremendous amount of revenue, it is true, but it has been coming from the oil pool down there, and every barrel of oil that comes out lessens that. So, why take a lot of time to prove what happened in the earlier stages until he lays a foundations that conditions were the same in 1941 as in 1936? It seems to me it would be entirely incompetent.

Mr. Melville: Mr. Cotton, will you please take the witness stand?

HENRY HAMILTON COTTON

called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: Your full name for the record, please.

The Witness: Henry Hamilton Cotton.

By Mr. Nelville:

Q. Mr. Cotton, what relation are you to Victoria L. Cotton? A. Husband.

Q. What is your position, if any, with the Dominguez Estate Company?

A. President of the company.

Q. Are you on the board of directors?

A. I am.

Q. What position? A. Director.

Q. Are you chairman of the board?

(Testimony of Henry Hamilton Cotton.)

A. No, I am president of the company. I don't know whether that would follow or not.

Q. Who is chairman of the board?

A. I don't know that we have any.

Q. The board of directors?

A. Well, if there is any, I am the chairman, but I am not referred to as that. [590]

Q. Are you a stockholder in the Dominguez Estate Company?

A. In a very small capacity. I own two shares.

Q. Is your wife a stockholder? A. No.

Q. Was your wife a stockholder in 1941?

A. I don't believe so.

The Witness: Will you give me the record on that, Mr. Arnold?

A. (Continued) I think she sold her stock in about 1938 or 1939.

Q. Whom did she sell it to?

A. Her daughters.

Q. For how much money?

A. She sold it for the same price that it was charged to her in the account, taking neither gain nor loss, and I think it was approximately \$1000.00 a share.

Q. I show you a document and ask you if you recognize any of the signatures on it.

A. (After examining) I recognize that signatures, I recognize this and I recognize that (indicating.)

Q. Will you state whose signatures they are?

A. This is my wife's, this, is the tax accountant

(Testimony of Henry Hamilton Cotton.)

that prepared the return, and this is the Notary Public who acknowledged the signatures. [591]

Q. What return is this?

A. This is the income tax return for the year 1939. It is dated here.

Q. By whom?

A. By Victoria L. Cotton, I imagine. (After examining) Yes.

Q. In that return was there reported the sale of any shares of stock of the Dominguez Estate Company?

A. It looks like there was here.

Q. How many shares? A. 99.

Q. And what was the amount realized?

A. \$99,000.00.

Q. Was there also reported on that same return the sales of any Francis Land Company stock?

A. It looks like .03—some very fractional share.

Q. .03267, is that correct?

A. That is what it says, for which she got \$32.67.

Q. And was there also reported a larger sale of Francis Land stock? A. Yes, 33 shares.

Q. What was the——

A. \$33,000.00. You realize, Mr. Melville——

Q. Answer the questions, Mr. Cotton. [592]

Mr. Mackay: He may explain.

The Witness: No, I won't try to explain. What is the use? I just want to say that the sale was set up at the price it cost her because——

(Testimony of Henry Hamilton Cotton.)

Mr. Melville: I think that is proper cross examination, your Honor?

The Court: Well, we will let the answer stand.

The Witness: It does not mean anything, I guess, anyway.

Mr. Melville: Your Honor, may I have the privilege of cross examining this witness on the ground that he is not a friendly witness?

The Court: He has not so shown himself to be as yet.

By Mr. Melville:

Q. Mr. Cotton, in making the report to the stockholders in 1940, did you make a statement in which you referred to the value of the Dominguez Estate Company stock?

A. Could I see that report?

(The document was handed to the witness.)

A. (Continued) (After examining) Yes, sir.

By Mr. Melville:

A. (Reading):

“In the unsettled condition of world and national affairs and the many problems that confront your company from day to day, we feel the ability to pay a return of 7.7 per cent on the basis of \$1000.00 per share of our stock is one thing that helps maintain the stability and value of this stock at somewhere near its appraised value.”

(Testimony of Henry Hamilton Cotton.)

Q. Thank you. Would you mind reading the first paragraph of that report, Mr. Cotton?

The Court: Are you asking the witness to read it into the record? Is that the purport of your question?

Mr. Mackay: If your Honor please, I think if any part of that report goes in the whole thing should go in.

Mr. Melville: I have no objection.

The Court: Well, why don't you agree upon what you wish?

Mr. Melville: I offer in evidence the entire report to the stockholders dated March 28, 1940.

The Court: It may be handed to the Clerk and marked for identification as Respondent's Exhibit CC. What mechanics will you use to make it available to us, gentlemen? Do you expect to submit a copy or what?

Mr. Mackay: We will get a copy.

Mr. Melville: Off the record.

(Discussion off the record.)

The Court: What shall we show on the record at [594] this juncture, gentlemen, that you are now proposing to offer as Respondent's CC a compared copy of the minutes of the corporation as of some date in 1940? Is that what you are going to do?

Mr. Melville: Yes, your Honor, March 28, 1940.

Mr. Mackay: Is that a report to stockholders?

Mr. Melville: Yes.

Mr. Mackay: It is a report to stockholders?

(Testimony of Henry Hamilton Cotton.)

Mr. Melville: Report to stockholders of Dominguez Estate Company, dated March 28, 1940.

The Court: We will assign you a number that may be used then, namely, Respondent's Exhibit CC, and when the compared copy is available it may be presented to us informally for filing.

(The report referred to was marked and received in evidence as Respondent's Exhibit CC.)

[Respondent's Exhibit CC, set out in full in Book of Exhibits.]

Mr. Mackay: If your Honor please, to clear up the record, it is a report dated March 28, 1940, for the year 1939.

Mr. Melville: It will speak for itself.

Mr. Mackay: Each year's report covers the previous year, not the future year.

The Court: This is a rather awkward way to proceed, gentlemen. You have here voluminous books, and unless you want to introduce all of the books in evidence and take them back to Washington, then you should agree upon some method of making [595] available to use the pages that you want in evidence. If you wish to do that by compared copies or by photostatic copies, of course, you may do so. I think we will suspend at this time for a brief recess for the specific purpose of allowing counsel an opportunity to go over the books briefly and see just what you propose to offer in evidence.

Mr. Melville: Your Honor, I stayed down——

(Testimony of Henry Hamilton Cotton.)

The Court: And then we can get along with the receipt in evidence of these documents or wait until we do get copies available.

Mr. Melville: That is an excellent suggestion, your Honor, but I would like the record to show that I did stay down and went over these books last night with Mr. Bennion, Mr. Mackay's associate.

The Court: That is all right. We need not worry about that. Would 10 or 15 minutes help you gentlemen get straightened out, Mr. Mackay and Mr. Melville?

Mr. Mackay: I think so.

The Court: To see just what you want in evidence? Very well, we will take a brief recess.

(A short recess was taken.)

By Mr. Melville:

Q. Mr. Cotton, did the Dominguez Estate Company——

The Court: May I ask you this, you made an offer of the entire report? [596]

Mr. Melville: That is now already in evidence.

The Court: It has not been received. If that is what you wish, the document may be handed to the Clerk and marked for identification as Respondent's Exhibit DD. That seems to be the report you are referring to.

Mr. Melville: It is my understanding that I now have in evidence the report to stockholders dated in the spring of 1941.

(Testimony of Henry Hamilton Cotton.)

The Court: Is this the same report that we have heretofore marked as Respondent's Exhibit BB?

Mr. Melville: No, your Honor.

The Court: Well, I am ruling that DD is not in evidence. You may make an offer. Let us complete the offer and either receive the document or reject it. CC is what you said would be furnished by a compared copy.

Mr. Melville: Off the record.

(Discussion off the record.)

Mr. Melville: Your Honor, I have gotten in as CC the report dated in 1940. When I started to talk about a paragraph of the report that was rendered in 1939 you suggested that I get together with counsel, and it is the paragraph with respect to the 1939 report that I am now going to offer in evidence, and I am starting to ask questions and lay the ground work for that.

The Court: You have already offered it. I don't mean to be arbitrary, but I am trying to keep my record straight. Now, you just got through a moment ago saying, "We offer this in evidence." Off the record.

(Discussion off the record.)

The Court: You may proceed, Mr. Melville. We will see if we can get straightened out.

Mr. Melville: I think I can straighten it out in a moment, your Honor.

The Court: Very well. You may proceed.

(Testimony of Henry Hamilton Cotton.)

Mr. Melville: I had three reports to stockholders that I have been talking about. I got one in evidence marked——

The Court: Respondent's BB.

Mr. Melville: And the next one I got in evidence marked Respondent's CC.

The Court: That was a copy of the minutes which I said you would furnish?

Mr. Melville: That is correct. Now, I have laid that book aside and I have in my hands the report to stockholders in 1939.

The Court: Very well. Then, so we will be straight, suppose you hand the Clerk at this time the document that you propose to offer as an exhibit and she may mark it for identification as Respondent's DD for identification.

Mr. Mackay: Now I am confused. I thought the report for 1939 was the last report that went in. Now I understand counsel is offering another report for 1939. [598]

Mr. Melville: Now, your Honor, the report was dated in 1940 and covered the year 1939. Now, this report is dated in 1939 and covers the year 1938.

The Court: Hand it to the Clerk and we will mark it.

Mr. Mackay: If your Honor, please, just a moment, I want to object to that as incompetent, irrelevant and immaterial.

The Court: You cannot object to it being marked for identification.

(Testimony of Henry Hamilton Cotton.)

Mr. Mackay: I am sorry: You are quite right, your Honor.

The Court: We will mark it for identification.

(The report referred to was marked as Respondent's Exhibit DD for identification.)

By Mr. Melville:

Q. Mr. Cotton, I ask you whether or not the Dominguez Estate Company ever changed its capital structure in order to provide a means whereby it could purchase its stock from its stockholders.

A. Yes, sir. [599]

Q. Would you read from your report which has been marked for identification as Respondent's Exhibit DD, the paragraph wherein you told your stockholders regarding the plan?

Mr. Mackay: I will let you read it into the record yourself if you want to read it.

Mr. Melville: Thank you.

The Court: Let me see if I understand what you are doing. You had a document marked for identification as Respondent's Exhibit DD. Am I correct in understanding that you do not propose to offer the document which has been marked as DD in evidence, but that you now propose under an agreement with opposing counsel to read in evidence one or more excerpts from that particular document? Is that what you are doing?

(Testimony of Henry Hamilton Cotton.)

Mr. Melville: That is my plan, your Honor.

The Court: Very well. Is there objection?

Mr. Melville: I believe he has stated he has no objection.

The Court: Do you wish to be off the record now, gentlemen?

Mr. Melville: Yes.

The Court: You may be.

(Discussion off the record.)

Mr. Melville: Mr. Mackay is correct. The report to stockholders is attached to the minutes of the annual meeting of the stockholders, dated April 14, 1937, and the paragraph that [600] I propose to read refers to what happened in 1936.

Mr. Mackay: Now, if your Honor please, I admit that that is a minute book and that paragraph is contained therein, but I object on the ground it is incompetent, irrelevant, and immaterial to any issue involved in this case. It is too remote. It has nothing to do with values in any sense of the term, and I object to it.

Mr. Melville: Your Honor, this might be considered in the nature of rebuttal. During the presentation of Petitioner's case he had experts who were applying all sorts of discounts because this stock was in a closely held corporation. If I can show that the corporation itself arranged its corporate structure so that it could buy from its stockholders their stock so that they would not have to

(Testimony of Henry Hamilton Cotton.)

sell it to the outside public, I think it is very pertinent and material to the issues in this case.

Mr. Mackay: If your Honor please, that hasn't anything to do with fair market value.

The Court: You gentlemen make it difficult for me to rule. Now, we have gone through the formality here of marking a document as an exhibit, and I assumed that you gentlemen expected to offer the exhibit in evidence. If you do, I will hear you as to any objections as to the receipt in evidence of the exhibit. Now, without my having examined the exhibit or having any conception of what is in it, and with you telling [601] me you think the whole matter is incompetent and irrelevant, I don't know whether it is or not because I don't know what is in it. What do you propose to do?

Mr. Melville: We reached the point, your Honor, where Mr. Cotton was about to read it, and Mr. Mackay said I could read it, he had no objection.

Mr. Mackay: Wait a minute. You were talking in your opening statement about the year 1939.

Mr. Melville: But it seems to me, your Honor,——

Mr. Mackay: I would like to call——

The Court: One at a time.

Mr. Mackay: I don't mind showing this to your Honor so you can understand what we are objecting to. It is quite proper, I think, to show the Judge the paragraph that they want in (handing).

Mr. Melville: If, your Honor, the corporation changed its corporate structure in 1937 so as to buy

(Testimony of Henry Hamilton Cotton.)

the stock of its stockholders, and that would be admissible according to Mr. Mackay's own statement on the record that I could read it into the record, then certainly if the corporate structure was changed farther back in 1936, it is even more important.

Mr. Mackay: Mr. Mackay has the privilege of objecting. He objects to any year prior to 1941.

Mr. Melville: I will go back to the question and answer form. [602]

By Mr. Melville:

Q. Mr. Cotton, did you ever make a—did the Dominguez Estate Company ever change its corporate structure in any year so that it was possible to buy the stock from the stockholders?

A. Yes.

Q. What year was that? A. 1936.

Q. Did you refer to that date in any report that you made to your stockholders?

A. In 1937 it was put in the report. Of course, the stockholders all knew it because they were a party to it.

Q. Will you please read into the record the paragraph which you put in your report to the stockholders wherein you told them about this change in corporate structure and the purpose for the change?

Mr. Mackay: I will reserve a motion to strike.

The Witness: Well, with all these objections and one thing and another, am I supposed to read it.?

The Court: Answer the question.

(Testimony of Henry Hamilton Cotton.)

By Mr. Melville:

Q. There has been no objection.

The Witness: Any objection, Mr. Mackay?

Mr. Mackay: Go ahead and read it.

The Witness: (Reading): [603]

“In May 1936 the company arranged to reduce its stated capital”—they had a stated capital of \$1,000,000.00—“to a sum not in excess of \$500,000.00 to create a surplus that could be used for the purchase of stock from stockholders of the Dominguez Estate Company who wished to dispose of their holdings. Prior to this time the company was not in a position, on account of its capital stock, to do this and, inasmuch as it was a closed corporation, there was no way for anybody to dispose of their stock except at a tremendous sacrifice. Under the present conditions stocks can be retained for members of the family and not get into outside hands by sales at depreciated values.”

Of course, I—I should not elaborate, I guess. The \$500,000.00 would not be very much stock.

Mr. Melville: Your Honor, in order to conserve the Court's time and the time of my expert witnesses, I am going to turn this witness over to the opposition for cross examination at this time, but I wish the witness to remain available so we can go through these books step by step at a later time in order to present the full picture.

(Testimony of Henry Hamilton Cotton.)

Mr. Mackay: If your Honor please, I would prefer, if it is agreeable with your Honor, to cross examine this witness when all his testimony is in.

The Court: Very well. For the record let me see [604] if I understand now what has happened to Exhibit DD. There has been no formal offer of that particular document, but the excerpt which was read into the record a moment ago came from Exhibit DD, is that correct?

Mr. Melville: That is correct, your Honor.

Mr. Mackay: Right.

The Court: Very well. Mr. Cotton, you may stand aside and counsel for the Government will wish to call you later.

The Witness: I thought he wanted to cross examine.

The Court: Mr. Mackay desires to defer the cross examination until you have completed your direct.

The Witness: Oh, I didn't know.

(Witness temporarily excused.)

Mr. Melville: Mr. Arnold, will you please take the stand?

HUGH G. ARNOLD

called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

(Testimony of Hugh G. Arnold.)

Direct Examination

The Clerk: Your full name, please?

The Witness: Hugh G. Arnold.

By Mr. Meville:

Q. What is your business, Mr. Arnold? [605]

A. I am a certified public accountant.

Mr. Melville: I hand the clerk a document which I asked to be marked for identification.

The Court: The clerk may mark it for identification as Respondent's Exhibit EE.

(The document referred to was marked as Respondent's Exhibit EE, for identification.)

By Mr. Melville:

Q. I hand you a document which has been marked Respondent's Exhibit EE and ask you if you recognize it?

A. (After examining) Yes, I do.

Q. What is it?

A. It is a gift tax return.

Q. Of whom? A. Lucille W. Martin.

Q. Does it bear your signature?

A. Yes.

Q. What year does it cover?

A. The year 1936.

Q. Does it contain a statement with respect to how you arrived at the value therein reported as--withdraw that question.

Does that return report the gift of any Dominquez Estate Company *tax*?

A. 15 shares. [606]

(Testimony of Hugh G. Arnold.)

Q. At what value? A. \$15,000.00?

Q. Does it report the gift of any shares of Francis Land Company stock?

A. Five shares.

Q. At what value? A. \$5,500.00.

Q. Does that return contain any statement as to how you arrived at those values?

A. Yes, it does.

Q. Will you please read it?

A. (Reading): "Values of shares in Dominique Estate and Francis Land Company taken from sales between September 29, 1936, and the date of the gift. Other values taken from actual sales on the date of the gift and/or New York Stock Exchange quotations on that date."

Mr. Melville: I offer the document in evidence as Respondent's Exhibit EE.

Mr. Mackay: Just a moment. If your Honor please, I object to this. It appears to be the return for 1936 of Lucille W. Martin, and I think it is entirely incompetent, irrelevant, and immaterial, and has no place here. It goes back to 1936. If your Honor please, if the Respondent is attempting to prove by this that this has any bearing, he must first show, as I understand, under the rules of law, that the conditions in [607] 1936 were the same as they were in 1941, which he has not done. He has not laid a sufficient foundation to justify the receipt of this document.

Mr. Melville: I believe, your Honor, that the value placed upon the stock by the stockholders

(Testimony of Hugh G. Arnold.)

themselves has a very direct bearing upon the price at which that stock will sell in an exchange between a willing buyer and a willing seller, and that this establishes not only one value placed upon the stock by one stockholder, but it is just the beginning of a long line of them that I am going to present. I cannot present them all at once.

Mr. Mackay: If your Honor please, do I understand counsel to say that just because Lucille Martin at that particular time in 1936, six years before the year we have involved, thought what she may have thought, has any material bearing upon this case or any relevancy? It is purely hearsay, and, if your Honor please, it is not proper. It just has no place in evidence.

Mr. Melville: Mr. Arnold prepared the return and what he stated on there with respect to sales is not hearsay.

Mr. Mackay: Mr. Arnold is not qualified as a witness to prove values.

The Court: The objection will be sustained.

By Mr. Melville:

Q. Mr. Arnold, do you have in court the books of Elsie [608] Rasmussen?

A. I believe they are here.

Mr. Mackay: If your Honor please, may I move to strike out what he read from this return on the same ground that I made my objection?

The Court: Well, I don't see where it is proper evidence. It seems to me it is hearsay. We will not

(Testimony of Hugh G. Arnold.)

sustain the motion to strike this, but it will not be considered.

By Mr. Melville:

Q. Do you have in court, Mr. Arnold, the books of Elsie Rasmussen?

A. I believe they are here, yes.

Q. Will you produce them, please?

A. (Producing).

Q. Will you examine those books and tell the Court whether or not Elsie Rasmussen made a sale of Dominguez Estate Company stock in 1941?

Mr. Mackay: Now, if your Honor please, I have tried a lot of cases and I have never heard of the books of someone not a party to it being introduced in evidence. That is purely hearsay and I object to the evidence.

Mr. Melville: Your Honor, if we were trying to prove the value of the stock of American Telephone & Telegraph Company and someone that is familiar with the market would testify that as of yesterday or today American Telephone & Telegraph was [609] sold by "X" individual to another unknown individual, that would seem to me to establish or tend to establish the fair market value of that stock, and that is what I am trying to prove here. One of the stockholders sold it to somebody else at a given value.

Mr. Mackay: The books of accounts kept by someone else do not prove a sale. It is pure hearsay.

The Court: The objection will be sustained.

Mr. Melville: Your Honor, I would like to state

(Testimony of Hugh G. Arnold.)

at this time that Respondent intends to subpoena Elsie Rasmussen, Victoria L. Cotton, Joseph N. Carson, and John F. Watson.

Mr. Mackay: I may say, your Honor, that I have no objection.

Mr. Melville: I will get around the hearsay.

Mr. Mackay: I am not objecting to the books of Victoria Cotton. She is a party to the suit. My objection goes to these others.

Mr. Melville: The books would still be hearsay, I presume.

Mr. Mackay: No, I will admit they are the correct books.

Mr. Melville: I will excuse the witness.

The Court: We have nothing to rule on. We are just talking. If you desire subpoenas issued, you may present your request. [610]

Mr. Mackay: There is no cross-examination.

The Court: You may stand aside.

(Witness excused.)

Mr. Melville: May we have a brief recess, your Honor?

The Court: Yes, we will suspend for a brief recess.

(A short recess.)

Mr. Melville: Your Honor, in view of the statement I made here last night about having one more witness on stock valuation who was not present, that prompts me to state for the record that that

witness was not under subpoena and he found it inconvenient or impossible to be present today. I will call my first witness on stock evaluation, Mr. Phillips.

RALPH E. PHILLIPS,

called as a witness for and on behalf of the respondent, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: Your full name for the record?

The Witness: Ralph E. Phillips.

By Mr. Melville:

Q. Mr. Phillips, what is your business?

A. I am a general partner of the brokerage and investment firm of Dean, Witter & Company.

Q. Here in Los Angeles? [611]

A. Yes, sir.

Q. Are you here under subpoena?

A. Yes, sir.

Q. Are you testifying reluctantly?

A. Yes, sir.

Q. What is your educational background?

A. I have been in the securities business for more than 20 years. Prior to that time, University of California and the Babson Statistical Institute. I am a graduate of those institutions.

Q. During that time have you had experience in valuing stocks?

(Testimony of Ralph E. Phillips.)

A. Yes, sir, that is one of our requirements in our general course of business.

Q. Have you also had experience in valuing the stocks of oil royalty companies?

A. Yes, sir. We have had that problem on a number of occasions.

Q. Have you had experience in valuing oil royalties themselves?

A. My firm does not deal in oil royalties as such. We have on several occasions bought the stocks of companies which had substantial income from oil, and in at least one occasion practically all of the income of a certain corporation whose shares we underwrote and distributed to our customers, was [612] derived from oil.

Q. And you understand the ways, the recognized means and ways, of valuing oil royalties?

A. I would say that as a member of a firm engaged in the distribution of securities, we do not consider ourselves to be experts on all such problems. It has always been our practice to employ recognized experts to assist us in those valuations, and in those situations, where the income of a corporation under consideration came substantially from oil, we invariably employed recognized experts to assist us. So, to the extent that their methods are known to us, I can say, yes, we have a general familiarity with those processes and practices.

Q. Now, then, Mr. Phillips, have you been pre-

(Testimony of Ralph E. Phillips.)

sented with the stipulation of facts and exhibits in this case? A. I have.

Q. And have you studied them?

A. I did.

Q. Were you asked to form an opinion as to the value of the stock of the Dominguez Estate Company? A. Yes, sir.

Q. Did you form such an opinion?

A. I did.

Q. Please state what it is.

Mr. Mackay: I object. The witness is not qualified. [613]

The Court: As of what date?

Mr. Melville: I am sorry, your Honor.

By Mr. Melville:

Q. Did you study the stipulation of facts and the exhibits to a view to forming an opinion as to the fair market value of the stock of the Dominguez Estate Company as of June 5, 1941?

Mr. Mackay: I object to that on the ground that sufficient foundation has not been laid for the question, and also on the ground that the witness is not qualified.

The Court: Overruled.

Mr. Mackay: Exception.

The Court: Yes, sir.

By Mr. Melville:

Q. What is your opinion?

A. I should like permission of the Court to read this report.

(Testimony of Ralph E. Phillips.)

Mr. Mackay: I object to that, if your Honor please.

The Court: I don't know what report you are referring to, Mr. Witness. What is it?

By Mr. Melville:

Q. You have notes there of your method of valuation that you would like to refer to in presenting your testimony?

A. Yes. Perhaps I should not have referred to it as a report. [614]

The Court: You mean your own notes?

The Witness: My own notes, a memorandum, and work papers.

The Court: Very well, you may refer to them.

The Witness: I have been asked to compute an estimate of the proper value for the stock of the Dominguez Estate Company. I also referred here to Francis Land, but since that is not a direct question I shall delay that for a moment with your permission.

By Mr. Melville:

Q. With the Court's kind permission, I will also ask you, then, Mr. Phillips, if you were also asked on the basis of the same stipulation of facts and exhibits to formulate an opinion as to the fair market value of Francis Land Company stock as of June 5, 1941? A. Yes, sir.

Q. And were you also asked—and did you formulate such an opinion? A. Yes, sir.

(Testimony of Ralph E. Phillips.)

Q. Were you also asked to formulate an opinion, based upon the same stipulation of facts and exhibits, as to the fair market value of the stock of Carson Estate Company as of June 5, 1941?

A. Yes, sir.

Q. Did you formulate such an opinion? [615]

A. Yes, sir.

Q. Will you please explain to the Court what your opinion is as to the fair market value of the Dominguez Estate Company stock, Francis Land Company, and Carson Estate Company as of June 5, 1941, and how you arrived at those values?

A. Yes, sir.

Mr. Mackay: I object to it on the same ground.

The Court: Objection overruled.

Mr. Mackay: Note an exception.

The Witness: Reading from my notes:

“I have been asked to compute an estimate of the proper value for the stock of the Dominguez Estate Company, Francis Land Company, and the Carson Estate Company, as of June 5, 1941. In making this estimate it has been necessary to proceed on certain assumptions.

“1. That the fair market value of assets of the company other than oil royalty interest has been agreed upon by stipulation between the parties and, therefore, no verification or appraisal of these figures has been attempted by me. In attempting to determine the value of these assets, which consist of current assets, stocks and bonds, ranch real estate, and other real estate, less current liabilities,

(Testimony of Ralph E. Phillips.)

it has seemed appropriate to use as a yardstick an arbitrary discount of 25 per cent of the stated net figure, inasmuch as as of this date it was [616] possible to purchase the shares of fixed type investment companies having non-leverage capital structure at a discount of approximately 25 per cent from their liquidated value.

“2. I have assumed that the probable future oil royalty receipts for the Dominguez Estate Company after June 5, 1941, will be in accordance with the figures stipulated between the parties for the period beginning June 1, 1941, and ending December 31, 1965. No value has been given to any balance of oil royalty receipts which may become available after December 31, 1965. In arriving at a present worth figure for these probable oil royalty receipts, I have applied a formula which involves the application of a tax deduction factor based upon State of California Franchise Tax and Federal Corporation taxes at rates existent as of June 5, 1941. This formula has also taken into account statutory depletion allowances of $27\frac{1}{2}$ per cent. To the figures thus obtained for each of the years under review, I have applied a present worth discount factor calculated at 5 per cent compound interest computed annually. The resultant figure I consider to be the present value of probable oil royalties. The total present worth computation has been divided by the number of shares of the Dominguez Estate Company outstanding as of June 5, 1941. To this per share figure I have applied [617] a further

(Testimony of Ralph E. Phillips.)

discount of 8 per cent, which represents the approximate profit margin which, as a dealer in securities, I would expect to earn upon resale of these shares to customers of my firm. This profit would be apportioned to distribution costs and the risk return on the capital involved."

The detail of this computation I have worked out in accordance with that general formula method. The stipulated fair market values are as follows: Dominguez Estate Company, Current Assets, \$869,-889.84; Stocks and Bonds, \$1,141,269.74; Ranch Real Estate, \$1,629,950.00; Other Real Estate, \$1,-631,266.69; Total, \$5,272,376.27, which represents a balance, less Current Liabilities, of \$292,677.09, of \$4,979,699.18.

I have applied in accordance with my formula——

Mr. Mackay: Not so fast. I can hardly follow you.

The Witness: Would you like a copy of this?

By Mr. Melville:

Q. Slow down a little bit, if you please.

The Court: Perhaps it may not be necessary to read all of these figures into the record, inasmuch as most of them appear in the stipulations, do they not, Mr. Melville? The figures he is reading are figures which appear in Joint Exhibit 1-A, Joint Exhibit 2-B, or Joint Exhibit 3-C? Where he is just reading from those figures, I think you may as well not have them in the record. [618]

Mr. Melville: I am perfectly willing, the witness

(Testimony of Ralph E. Phillips.)

having expressed his opinion, to let the computation that he is reading go into the record. Would you like that, Mr. Mackay?

Mr. Mackay: I don't like any of it.

Mr. Melville: I think it would be better if he read it through slowly.

The Court: I was just trying to avoid reading into the record a lot of figures because I won't read them anyway when I get to reading this if they are the same as in the exhibit. If those are the figures, there is not much point in reading them into the record.

Mr. Melville: But there is more than one way to handle a set of figures, your Honor.

The Court: I don't want to interfere. Proceed. You may proceed whatever way you deem best.

The Witness: To the balance of \$4,979,699.18, I have applied a discount in accordance with my formula as explained earlier of 25 per cent, which is \$1,244,924.79, leaving a balance of \$3,734,774.39 as the figure to be divided by the number of shares outstanding, which gives a resultant figure of \$355.00 per share for assets other than oil royalties of the Dominguez Estate Company.

Now, for the oil royalty ownership, the stipulated future gross income to be received prior to January 1, 1965, is [619] \$8,660,511.00. Now, in accordance with the formula, I have taken a tax factor which figures to be 19.82 per cent of the gross royalty income, and that was explained earlier, and I can explain the detail of that if it is required.

(Testimony of Ralph E. Phillips.)

That amounts to a tax reduction of \$1,716,512.00, leaving a figure of probable net income from oil royalties after taxes of \$6,943,999.00.

“To this figure has been applied a discount of 5 per cent compound interest to adjust to present worth. This results in an average valuation for the period under review of 0.710598 per cent, or a total present worth value for probable oil royalty receipts after taxes and depletion adjustment of \$4,934,391.00.

“Dominguez Estate Co.

“Present Worth Probable Oil

Royalties	\$4,934,391.00
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Divided by 10,499 shares outstanding	470.00 per share
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Value per share of Assets other than oil	355.00
--	--------

Value per share of Oil Royalty Interests	470.00
--	--------

Combined	\$ 825.00
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Less—Discount of 8% to represent selling costs and profit to dealer	66.00
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Value Dominguez Estate Co.....	\$ 759.00 per share
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“Francis Land Co.

“This company owns miscellaneous assets having a stipulated value consisting of:

(Testimony of Ralph E. Phillips.)

“Current Assets	\$10,919.59
Stocks and Bonds.....	21,630.00
Real Estate	50,672.31
Total	<u>\$83,221.90</u>

Current Liabilities are stated to be..... \$85,331.44

“The resultant red figure of \$2,109.44, based on the 5,000 shares of stock of the company outstanding creates a red figure of .42 per share. This figure has been disregarded in these calculations. In addition, the company owns 5,499 shares of the Dominguez Estate Co., which have been valued by this study at \$825 times 5,499 equals \$4,536,675.00.

“Divided by 5,000 shares outstanding.... \$907.33 per share
 Less—8% to allow for dealer..... 72.59

Distribution costs and profit..... \$834.74 per share

“Carson Estate Co.

“Owns miscellaneous assets having a stipulated value as follows:

“Current Assets	\$201,936.05
Ranch Real Estate	446,418.04
Other Real Estate.....	147,200.00

Total	<u>\$795,554.09</u>
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“Current liabilities	\$ 34,157.48
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	<u>\$761,396.61</u>
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Less—25% Discount to adjust to a reason- able market appraisal for similar type con- cerns	190,349.00	\$571,047.61
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Divided by 7,412 shares outstanding	\$ 77.00 per share
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(Testimony of Ralph E. Phillips.)

“In addition, Carson Estate Co. owns:

1,353 Sh. of Dominguez Estate Co.	
\$825 x 1353	\$1,116,225.00
1,785 Sh. of Francis Land Co. \$907.33 x	
1785	1,619,584.00
	<hr/>
	\$2,735,809.00

Divided by 7,412 shares

outstanding \$368.00 per share

“The company owns oil royalties which by stipulation have probable future income for periods beginning June 1, 1941, and ending December 31, 1965, totaling \$476,542.00. By applying the same tax and depletion factor used in valuing the royalty income of Dominguez Estate Co. and applying a present worth discount factor using 6 per cent* compound interest instead of 5 per cent as used in the Dominguez Estate Co., a present worth value for probable future income of \$285,838.00 has been established. This figure divided by 7,412 shares outstanding produces a value of \$38.50 per Sh. [622]

“Summarized, this gives a value to Mis-

cellaneous Assets of.....	\$ 77.00 per sh.
Francis Land Co. and Dominguez Estate	
Co.	368.00 per sh.
Oil Royalty Holdings (Present Worth)	38.50 per sh.
	<hr/>
	\$483.50
Less—8% for selling costs and profit to	
dealer	38.68
	<hr/>
Total	\$444.82 per sh.”

*Note—A 6% interest figure has been used because of the generally less desirable character of the Carson Estate Oil royalties as compared to those received by the Dominguez Estate Co.

(Testimony of Ralph E. Phillips.)

Now, I have my work papers which I believe can be used to demonstrate the arithmetic of how I arrived at those various calculations, and they are available.

Mr. Melville: Off the record.

The Court: Off the record.

(Discussion off the record.)

Mr. Melville: I ask that these two documents be marked for identification.

The Court: What are they?

Mr. Melville: The work papers of this witness in making his computations showing the various factors that he took into consideration. May they be marked, your Honor?

The Court: They may be marked for identification as Respondent's Exhibit FF.

(The document referred to was marked as Respondent's Exhibit FF, for identification.)

The Court: You may proceed, gentlemen. [623]
By Mr. Melville:

Q. Are the documents marked as Respondent's Exhibit FF the work papers you referred to?

A. Yes, sir.

Mr. Melville: I offer them in evidence, your Honor.

Mr. Mackay: I object to them, if your Honor please, on the ground they are incompetent, irrele-

(Testimony of Ralph E. Phillips.)

vant, and immaterial. It is not proper evidence.

Mr. Melville: It is going to help you out.

The Court: Is the offer withdrawn?

Mr. Melville: I wish your Honor would rule on the objection.

The Court: I don't think the documents themselves constitute proper evidence. The witness puts them in and offers those merely as work sheets and how he worked out the problems of arithmetic.

Mr. Melville: It is only explanatory, your Honor.

The Court: Very well. We will not receive the documents.

By Mr. Melville:

Q. Mr. Phillips, now, in your testimony what was the total value that you used for the oil royalties of the Dominguez Estate Company?

A. The final figure, you mean? [624]

Q. The total value of the—the value of all of the oil royalties of the Dominguez Estate Company as of June 5, 1941. I don't mean per share of stock, but the entire oil royalties. Do you have that figure?

A. After applying the several discounts and formulas as explained, it amounted to \$4,934,391.00.

Q. And what is the figure for the oil royalties of the Carson Estate Company?

A. On the same basis, it is \$285,838.00.

Q. When did you arrive at that value of \$280,000.00 and some?

(Testimony of Ralph E. Phillips.)

A. You mean \$285,000.00 for Carson?

Q. That is right.

A. About 10 days ago after running these tables.

Q. At the time you arrived at that figure, then, you knew nothing whatsoever of the stipulation in this case as to the value of those oil royalties?

A. No, sir.

Mr. Melville: Off the record, please.

(Discussion off the record.)

Mr. Melville: On the record.

By Mr. Melville:

Q. Mr. Phillips, do the work sheets marked for identification as Respondent's Exhibit FF show how you arrived, the detail of arriving, at those appraisals of the oil royalties [625] in the Dominguez Estate Company case, as well as the Carson Estate Company, how you took into account the various adjustments? A. Yes, sir.

Mr. Melville: I again offer these exhibits in evidence, your Honor, to show the detail of taking into account the various factors including the interest and other discounts that have been talked about in this case.

The Witness: I would like to amend my answer if I may. These records do not take into account the 8 per cent discount for dealer's profit and sales costs that I mentioned earlier. This is purely an arithmetical computation arriving at the present worth of the future probable oil royalty income.

(Testimony of Ralph E. Phillips.)

Mr. Mackay: If counsel will let met me take a look at that and defer offering it right now, maybe we can save a little time.

Mr. Melville: Very well (handing).

By Mr. Melville:

Q. Mr. Phillips, in your connection with your firm of Dean, Witter & Company, have you had experience with the stock of the Kern County Land?

A. Yes, sir.

Q. Is there any comparison between the stock of Kern County Land and the stock of these three companies, in your opinion? [626]

A. Yes. The Kern County Land Company was originally a closely held family corporation having few, if any, outside stockholders. That parallel is not existent at the moment because the Kern County Land Company now has a wide number of public stockholders, but at one time there was that parallel between these three family owned companies and the Kern County Land Company.

Mr. Mackay: I object to that, if your Honor please, unless the time be specified, and I move that it be stricken unless he specifies the time. [627]

The Court: Can you state the time?

The Witness: I will say that up until July, 1934, the Kern County Land Company was a closely held family corporation. Thereafter, due to the activities of my firm and others, the stock became in part distributed to the public.

The other parallel between the Dominguez Estate

(Testimony of Ralph E. Phillips.)

Company and Carson Estate Company particularly and the Kern County Land Company is this, that all three companies in common had and currently have substantial land holdings. They had agricultural operations, they had real estate assets outside of the agricultural operations, and they had and have substantial oil royalty income. So, there is a further parallel there in that the operations of those three concerns are along similar and parallel lines.

By Mr. Melville:

Q. When Kern County Land first made its stock available to the public, did you firm have anything to do with its distribution? A. Yes.

Q. Will you tell the Court about that?

A. As of approximately July, 1934, and I may be a little hazy on the date, my concern purchased from a stockholder who wished to sell a substantial percentage of the total outstanding stock of the Kern County Land and sold it to the public. [628]

Q. Upon what basis did you buy that stock?

A. Well, we bought it on a basis of what we considered to be a reasonable price in view of all the circumstances which were then prevelant. That is a long story and I don't think it has any relevancy to this matter, but I will be glad to outline it if you wish.

Q. Did you consider asset value back of the stock? A. Yes.

Q. Mr. Phillips, you have testified as to the values of these three stocks. What do these values

(Testimony of Ralph E. Phillips.)

represent, value to the willing seller, value to the willing buyer, or the price at which your firm would be willing to buy the stocks, or just what do they represent?

A. They represent values that my firm would consider reasonable, values as of that time under those circumstances, were we called upon to buy this stock for distribution to our customers.

Q. And if you had bought the stock at that price, would you have contemplated selling it at a profit?

A. We would probably have attempted to buy it on the basis of the valuations I have used. The eight per cent discount factor I have outlined as being a proper factor would have represented the profit. In other words, the seller would have paid the commission—would have paid us our profit, it would not have been a commission, it would have been a profit to us, but the [629] seller would have paid that rather than the buyer.

Q. Then, as I understand it, if you had made a bid of these prices for these stocks and had turned around and sold them to your clients at the same price, your firm would have derived a profit of eight per cent?

A. That is correct.

Mr. Mackay: If your Honor please,—wait.

The Court: The answer may be stricken.

Mr. Mackay: I object to it on the ground it is incompetent, irrelevant and immaterial. The witness is not yet qualified by his own testimony to pass upon the value of oil royalties. His whole

(Testimony of Ralph E. Phillips.)
testimony is based upon that. He says he knows nothing about it.

Mr. Melville: That is proper cross-examination, it seems to me.

Mr. Mackay: No, you have got to lay your own foundation.

The Court: The question as phrased is objectionable, I think, as to whether or not he would have made a profit.

By Mr. Melville:

Q. If your firm had made a bid for these stocks at the figures that you have testified to and had been successful in buying them at those prices, state whether or not they would have been offered to the public at the same price.

Mr. Mackay: I object to that, if your Honor please, [630] on the same ground.

The Court: It is very speculative. I would think. He has given his estimate of the fair market value. I don't believe the question as phrased is a proper question, Mr. Melville.

By Mr. Melville:

Q. Mr. Phillips, you are familiar with the dealings on the Los Angeles Stock Exchange?

A. In general, yes, sir.

Q. Are there stocks that are traded on the Los Angeles Stock Exchange rather infrequently?

A. Yes, sir.

Q. Will you explain for the record what "bid

(Testimony of Ralph E. Phillips.)

and asked" means in connection with the stock market?

A. The bid side of the market is the price that a willing buyer will pay. The asked side is the price that a willing seller will sell for.

Q. Now, with respect to that, what do these prices that you have testified to in this case represent?

Mr. Mackay: I object to that, if your Honor please. It is incompetent, irrelevant and immaterial.

The Court: Off the record.

(Discussion off the record.)

Mr. Mackay: It is too speculative, if your Honor please. It has no place in the record here.

The Court: Will you read the record back?

(The record was read.)

The Court: He may answer.

Mr. Mackay: Note an exception.

The Court: The exception may be noted.

The Witness: They represent the price that my firm, I believe, would have been willing to pay for the shares involved as of that date.

By Mr. Melville:

Q. Do they represent the bid or the asked?

A. They would represent the bid.

Mr. Mackay: There is no bid. I move that be stricken.

(Testimony of Ralph E. Phillips.)

By Mr. Melville:

Q. Now then,——

The Court: Just a moment. Of course, we should keep in mind the thing that we are trying here is the fair market value, having in mind your hypothetical willing seller having knowledge of the facts and the hypothetical willing buyer having knowledge of the facts. Now, I assume from the witness' testimony that what he is attempting to give us is his idea of the fair market value on the basic date. Isn't that correct?

The Witness: That is correct.

The Court: I don't believe we need to go into the question of bid and asked prices and so on. I think we know in a general way, all of us, what that means. He has given us his idea of fair market value on the basic date and I don't believe that would be helpful, would it, Mr. Melville?

Mr. Melville: Perhaps not, your Honor. Withdraw the question.

By Mr. Melville:

Q. Mr. Phillips, since you have stated that your firm would have been a willing buyer in this hypothetical situation we are dealing with at the prices that you testified to, and you had not found a willing seller at those prices, would your firm have been willing, in your opinion, to have gone up in order to meet any demands on the hypothetical willing seller?

(Testimony of Ralph E. Phillips.)

Mr. Mackay: I object to that, if your Honor please, as too speculative. It is just not proper in this kind of a case.

The Court: I will sustain the objection.

Mr. Melville: Your witness.

Cross Examination

By Mr. Mackay:

Q. Mr. Phillips, did you prepare all these figures yourself?

A. I prepared the formula, yes, sir. [633]

Q. You prepared the formula?

A. Yes, sir.

Q. But did you not check the figures?

A. Yes, sir.

Q. But you did not prepare the figures?

A. No, I did not.

Q. The figures were worked out by someone else, were they?

A. That is correct.

Q. Where did you get the formula from?

A. As I stated earlier, my firm and none of its partners consider themselves to be experts in all lines of endeavor, all lines of business. We employ accountants when we want an accounting job done. We hire lawyers when we seek legal advice. When we want advice on technical matters, such as oil royalty valuations, we rely upon the best talent among qualified oil authorities that we can obtain. This is a formula which was, and we still believe it

(Testimony of Ralph E. Phillips.)

to be, a reliable formula and which was given to us by a qualified engineer.

Q. If your company, Mr. Phillips, were going to contemplate purchasing shares and distributing them to the public, the first thing it would do, particularly if the stock it was going to purchase had underlying assets of oil royalties—your company would want to be pretty sure with respect to the fair market value of the oil royalties, wouldn't they? [634] A. Yes, sir.

Q. And your company would seek the advice of some very competent engineer to give you that?

A. Yes, sir. We have done that.

Q. Have you ever used Paul Paine for that purpose? A. Yes, sir.

Q. Several times? A. Yes, sir.

Q. You regard Paul Paine as a very capable engineer? A. We have employed him.

Q. As a matter of fact, didn't you employ him—I will withdraw that. Now, you say that you are not equipped to pass upon the fair market value of oil royalties? A. That is correct.

Q. That is what I understand. I think you stated, Mr. Phillips, that your fair market value of the Carson Estate oil royalties, arrived at by the use of the formula, was \$285,838.00? I am approximately correct, am I not?

A. That is correct.

Q. Now, let us assume that the average daily production from those oil royalties of Carson on the date we are concerned with, namely, June 5,

(Testimony of Ralph E. Phillips.)

1941, was 200 barrels per day, can you figure out what value there would be to each barrel of oil in the ground?

A. I don't think that is a proper question to ask in [635] this connection and I would——

Q. Why is that?

A. Well, because the valuation of 200 barrels per day—you are asking an abstract question here—would depend upon a lot of factors which are not at issue in this matter, such as the price of oil, tax rates, and so on. They are not in issue and I don't think that is a proper question to ask.

Q. I know, but couldn't you just assume it is a proper question and answer the question?

A. How would I value \$200 barrels per day?

Q. No, I didn't ask you that. I merely asked you to assume that the average daily production on the Carson oil royalties were 200 barrels. You have established a value of \$285,000.00, testified to a value of \$285,000. Now, how much is that per barrel? Can you figure that out?

A. Yes, I could figure that out if you gave me time.

Q. Will you please do that?

A. I won't attempt to do that now. It is a technical——

The Court: I am not sure I understand what you mean by your question, Mr. Mackay.

Mr. Melville: I don't want to limit the scope of the cross examination, your Honor, but it seems to me that he ought to ask questions which are com-

(Testimony of Ralph E. Phillips.)

plete in themselves and not just give him 200 barrels per day as a figure and expect him to assume a whole lot of other factors which are not posed [636] in the question.

The Witness: I have made it clear——

The Court: Just a moment. Mr. Phillips.

Mr. Mackay: I will withdraw that question, your Honor. It is confusing I will grant that.

The Court: All right.

By Mr. Mackay:

Q. You have stated, I think, that in your opinion the value there is \$285,838.00 for the Carson oil royalties? A. Yes.

Q. Now, in the stipulation you also saw, did you, the number of barrels that was estimated?

A. Mr. Mackay, what I did was to place a valuation upon figures of dollar return not barrel return over a period of years, which I understood were agreed to, and all I did was apply the formula that I have explained to you. Now, if you want to get me into other methods, I would have to consult my engineer on it. All I did was to value the stipulated dollar income over a period of years.

Q. And you ignored the barrels?

A. That was not given me. I have no idea what the barrels were. That was never a factor in this matter as far as I am concerned. I was given the dollar return.

Q. I believe the record will show that the barrels per day was not introduced into evidence until

(Testimony of Ralph E. Phillips.)

after this trial [637] started and was introduced by the Petitioner.

A. I have no idea what the barrel factor was.

Mr. Mackay: May I have the stipulation, please?

(The document was handed to Mr. Mackay.)

By Mr. Mackay:

Q. Did I understand you to say that you had been given a copy of these exhibits?

A. All these exhibits that you show me on top there, yes.

Q. What number is that?

Mr. Binnion: 12-L-1.

By Mr. Mackay:

Q. Were you not given a copy of the estimated oil reserves in barrels? A. No, sir.

Q. You were not given that? A. No, sir.

Q. Were you given a copy of the estimated probable future recovery in barrels?

A. No, sir.

Q. You were not? A. Dollars only.

Q. You were only given dollars? So then, your opinion is based solely upon dollars, isn't it?

A. Dollar return, because the dollar return is based upon the price of oil, and I have had no connection whatever [638] with determining the formula for making up this stipulated dollar return over the period of years. I made no effort to value that in any other manner except the use of monetary return.

(Testimony of Ralph E. Phillips.)

Q. What was the price of oil that you used?

A. I have no idea. Dollar return is all I am concerned with.

Q. So you did not consider the price of oil?

A. None whatever, the stipulated value on the oil and gas or what not.

Mr. Melville: Your Honor——

By Mr. Mackay:

Q. Did you ever go on the property?

Mr. Melville: It seems to me, your Honor, that counsel is trying to go back of the stipulation. We have Mr. Paine's future oil royalty income and it is in the stipulation and our witnesses were not asked to go back of that stipulation.

Mr. Mackay: I don't know what your witnesses were asked.

The Court: I would suggest, gentlemen, that perhaps we are making a mountain out of a mole hill. The witness has testified that all he did was to take the stipulated figures given to him with reference to the dollar return, and upon those figures he applied with various factors which he has related and has concluded that the fair market value on the basic [639] date of the right to receive that amount of money as oil royalties was \$285,000.00.

By Mr. Mackay:

Q. Were you given a copy of the stipulation?

A. No.

Q. You were not given a copy of the stipulation?
A. No, sir. I have never seen it.

The Court: Off the record.

(Discussion off the record.)

The Court: I am about to suspend. Will you be able to finish with this witness?

Mr. Mackay: No, your Honor, I cannot before lunch.

The Court: We will suspend at this time until 2:00 o'clock.

(Whereupon, at 12:30 p. m., a recess was taken until 2:00 p. m. of the same day.) [640]

Afternoon Session. 2:00 p. m.

RALPH PHILLIPS,

recalled as a witness for and on behalf of the Respondent, having been previously duly sworn, was further examined and testified as follows:

Cross Examination—(Resumed)

By Mr. Mackay:

Q. Mr. Phillips, I believe you have some explanation to make with respect to the testimony you just gave just before we adjourned.

A. Yes.

The Court: Pardon an interruption. Off the record.

(Discussion off the record.)

The Court: On the record.

The Witness: I believe the question referred to

(Testimony of Ralph Phillips.)

was had I or had I not seen the stipulation between the parties. And I answered the question that I had not seen it. That was not correct. Yesterday or the day before a young gentlemen from the office of the Respondent brought a copy of that stipulation to my office and sat down and asked me to read it. I did read it without realizing what the text of the material was. I did read it carefully. I didn't realize that is what you referred to, if I may so state. I have seen that stipulation between the parties. [641]

By Mr. Mackay:

Q. Now, Mr. Phillips, I think you testified something about the Kern County Land Company and that your company acquired that in 1934, a substantial block of stock. A. Yes.

Q. You acquired that from Mr. Blanding; didn't you?

A. I believe so, yes, sir.

Q. He was pretty old at the time; wasn't he?

A. Yes, sir.

Q. And very anxious to sell? A. Yes.

Q. Didn't you acquire that at a price equivalent to something less than the current assets?

A. We did, and there is an explanation for that. The background of the circumstances were this: Mr. Sinclair was running for Governor in this State. People of property interests and wealth were very much alarmed by the socialistic trend of Government in California.

(Testimony of Ralph Phillips.)

Agriculture had been a highly and profitable venture on a large scale for a number of years. Remember, this was 1934 and we were only just coming out of the first phases of the so-called depression.

Mr. Melville: If your Honor please, I believe it was pretty well established this morning that we shouldn't go too far back of 1941 in making comparisons. We are back [642] to 1934 now, and I would like to object on the ground it is not close enough to our basic date.

The Court: Well, the witness told something about this transaction while on direct. I think it would be perfectly proper for cross examination. The objection will be overruled.

The Witness: Shall I continue?

The Court: You may continue.

By Mr. Mackay:

Q. That stock was purchased by you for around \$33.00 a share?

A. No; \$30.00 a share.

Q. It sold for \$33.00 to the public?

A. We offered it to the public at \$33.00 a share.

Q. You had considerable difficulty selling it at that; didn't you? A. Yes and no.

Q. Well, did you?

A. The most of it sold very quickly.

Q. Well, some of it was a little slow in moving?

A. Perhaps 10 per cent of the amount we acquired was with us for a month or two. But the bulk of it was sold quickly.

(Testimony of Ralph Phillips.)

Q. Some of your firm members had to buy the balance of 1500 shares?

A. I wouldn't say they had to. They bought it by choice. I was one of them. I regarded that favorably. [643]

Q. By the way, at that time didn't the Kern County Land Company have about 68,000 head of cattle?

A. That I couldn't say.

Q. They had a large bunch of cattle?

A. Something over 60,000 head perhaps.

Q. They had three or four million acres of ground?

A. No, they had a little over a million acres in Arizona and New Mexico, which was considered to have little or no value. And they had 513,000 acres in Kern County, California.

Q. A lot of it was agricultural land; wasn't it?

A. Well, it had no other value except for agriculture, except for a small amount of oil which had been found in earlier years, but which was considered to have been almost fully completed.

Q. They did own the water rights in the Kern River; didn't they?

A. Yes, and they were valuable.

Q. Is that your understanding that the Dominguez Estate has a lot of agricultural land to be compared with the agricultural land of the Kern County?

A. Nothing like the same scale.

Q. Do you know whether they have an agricultural land?

A. It so states.

Q. Agricultural land?

(Testimony of Ralph Phillips.)

A. Ranch land. I presume ranch land means agricultural [644] land.

Q. You don't know whether they were producing crops on it?

A. I stated in my first qualifying remarks that I had not seen the properties. I had not seen the property, had made no attempted verification. I took the figures as stipulated and I will rely upon them until I am given some other basis.

Q. I think you stated that you used a procedure whereby you took the total estimated income and then you applied a certain factor there for taxes. Is that what you did?

A. If you are referring to oil royalties, yes, sir.

Q. Yes. Then you also, after you did that, you took a discount of that figure by five per cent; is that right?

A. Well, the five per cent was not five percent of the total income, it was five per cent at compound interest, figured annually of the total. It figured out a discount factor of more than 29 per cent of the total figure, but it was five per cent compounded semi-annually.

Q. Then you came to the conclusion that would be the fair market value; didn't you?

A. Yes.

Q. What do you mean by fair market value?

A. A price which I would be willing to buy it for.

Q. And your figure was how much? [645]

(Testimony of Ralph Phillips.)

A. If you are talking about Dominguez Estate Company it was \$4,934,391.00.

Q. Now, do you mean to tell the Court that your firm would be satisfied with a five per cent profit on that deal?

A. That isn't what I stated at all.

Q. Do you think you could recommend to your clients to purchase that on the basis they would get a five per cent return?

A. They would get the return of their principal, plus five per cent at compound interest.

Q. That is what I mean. They would get a return of their principal, plus five per cent.

A. That is the method we used.

Q. Do you think that is sufficient return for oil properties?

A. You are getting your money back.

Q. Is that all the prospective buyer is interested in?

A. This is a basis we would have been willing to buy it, I am sure, at that time.

Q. How long would it take to get your money back?

A. A period of about 25 years.

Q. Well, suppose you had a good corporate bond, what rate of return would you want on that capital back, plus——

A. As of 1941, a good corporate bond would have produced a rate of return of about 3-3/4ths per cent; currently about [646] 2-3/4ths.

(Testimony of Ralph Phillips.)

Q. Now, you speak about this procedure. Where did you get that procedure?

A. This formula for valuing?

Q. Yes.

A. From an engineer in whom we have confidence.

Q. You call it a formula?

A. Yes, it is a formula.

Q. What is the formula?

A. I have explained it. Do you want me to go into it again?

Q. You read it. I wish you would explain it to me now.

A. It is the stipulated probable oil royalties which you people have, as I understand, agreed upon as the rate per year to be returned from the oil royalty income, less a factor representing taxes, based at the then existent tax rates, which were California Franchise tax and Federal Corporation tax. That produced a figure which was probable net income after taxes; in dollars mind you, a probable net income after taxes. To that I have applied a present worth factor, calculated at five per cent compound interest figured annually.

By applying those series of deductions the figure of eight million six hundred sixty thousand, which was the total amount which would be received by stipulation, excluding the [647] amount after 1965, would be reduced to \$4,934,391.00. A reduction of about 40 per cent in the total gross return.

Q. Now, did the engineer tell you that figure was market value?

A. I beg your pardon.

(Testimony of Ralph Phillips.)

Q. Did that engineer tell you that figure was market value?

A. We have had no engineer review these figures. I am merely applying a formula or a series of reductions to a gross figure which would have been the result had we employed our engineer; at least, we have reason to believe that would have resulted.

Q. Where did you get the formula?

A. I explained that to you.

Q. No, you haven't. Was it written out?

A. It was used on more than one occasion by this engineer.

Q. Was it ever displayed by that engineer to you? A. Yes.

Q. In what instance?

A. In the appraisal of the Dominguez Oil Field property.

Q. Have you seen a copy of that?

A. Yes.

Q. Do you have a copy on your desk?

A. Yes. [648]

Mr. Melville: Introduce it in evidence.

By Mr. Mackay:

Q. Will you please refer to page 1?

The Court: Page 1 of what?

Mr. Mackay: Of that appraisal report he has before him.

The Witness: Yes, sir.

(Testimony of Ralph Phillips.)

By Mr. Mackay:

Q. That is the procedure you followed in estimating the value you place here?

A. No, this is a little different.

The Court: May I inquire, what is it you are looking at? Is it in evidence? That is all I wanted to know.

Mr. Mackay: No, this is not in evidence.

The Court: I see. All right.

The Witness: It is a little difficult in that this report which was prepared by Mr. Paul Paine, who is present here,—he may be willing to explain the situation himself; he prepared the report.

By Mr. Mackay:

Q. Well, I am interested in your explanation right now.

A. That is qualified by stating that he not only had to estimate the barrels of returnable oil over a period of years, but furthermore the rate of return, the price of oil and the taxes included. [649]

Q. All right.

A. Now, you may go on. I will explain. I am prepared to.

Q. That is fine. Then in his report Mr. Paine estimated the net oil reserves at approximately 41,000,000 barrels; doesn't he?

A. Yes, 41,000,000 barrels.

Q. And the discounted future value per share was \$66.64.

A. Yes.

Q. What was the procedure you followed here?

A. You have engaged in a number of short cuts.

(Testimony of Ralph Phillips.)

Mr. Melville: Your Honor, I ask opposing counsel if he is trying to cross examine Mr. Paine's method of valuation of the method this witness has used——

Mr. Mackay: Well, I am trying to find out what this witness did and how he arrived at it. I have that privilege.

The Court: I doubt if there is anything for me to rule upon. You may ask another question, Mr. Mackay.

Mr. Mackay: Will you please read that question?

(The record was read.)

By Mr. Mackay:

Q. Now, Mr. Paine has reduced that to per share, based upon 400,000 shares, and got \$66.74 per share?

A. That is right. [650]

Q. Is that the equivalent of the four hundred ninety one thousand you arrived at?

Mr. Melville: If your Honor please, if we are going to analyze the method of appraisal, I think we ought to put the whole thing in evidence and not pick out parts of it here and there and elsewhere.

Mr. Mackay: I am amazed.

Mr. Melville: It is your privilege.

Mr. Mackay: All I am trying to find out is to find out what formula the witness used and how he applied it.

The Court: The form of your question is, to say the least, a little bit difficult or ambiguous, so

(Testimony of Ralph Phillips.)

far as I am concerned. You are talking about some report that you and the witness seem to have in your hands, and you refer to it in general terms, and yet I don't have it, so I will have difficulty in re-reading this record to know exactly what you were talking about.

If you wish to talk about the report or what he has done, and can put it in language or figures that may be understood from a cold record in this case, it would be more helpful to me, I believe.

Mr. Mackay: Yes. I will withdraw that question.

Mr. Melville: There is only about six lines to that computation. Why don't we put it in?

The Court: You may proceed with the cross examination [651] of the witness.

By Mr. Mackay:

Q. Now, you arrived at a figure of \$4,900,000, approximately; didn't you? A. Yes.

Q. Now, that is your value; isn't it?

A. That is present worth value of the oil, probable oil receipts after taxes.

Q. Was that fair market value?

A. I would consider it to be. I have already stated that I believe that my firm would have been prepared to make that kind of an offer, based upon that figure.

Q. Now, do you know how many shares there are outstanding in Dominguez Estate Company?

(Testimony of Ralph Phillips.)

A. I couldn't tell you what are outstanding—now, as of this date, I do.

Q. How many? A. 10,499.

Q. Will you divide 10,499 into four million, the figure you have there?

A. Yes, I have done so. It is \$470.00.

Q. \$470.00? A. Yes.

Q. In the formula you say you used, which you got from Mr Paul Paine, Mr. Paul Paine showed a per share value there [652] of per share present worth of \$66.74; isn't that right?

A. If you are still talking about the Dominguez Oil Fields, Ltd., that is correct.

Q. Yes. A. Yes, sir.

Q. What did you pay for the stock?

A. What did who pay for the stock?

Q. Dean Witter.

A. I don't know what you are referring to. You haven't asked the question, if you are talking about Dominguez Oil Field Estate.

Q. Yes.

A. You have asked no leading question up to that point. What did we pay for what stock and when?

Q. Did Dean Witter buy the stock of Dominguez Oil Fields Company?

A. We dealt in it frequently.

Q. Did it do it in—did you make a public offering of the Dominguez Oil Field Company stock?

A. Yes.

(Testimony of Ralph Phillips.)

Q. And that was done about 1938; wasn't it?

A. Yes, sir.

Q. That was done about the same time of the appraisal on the Dominguez Oil Field stock, the same time Mr. Paine made——

A. Mr. Paine made this report, in support of our bid [653] for that stock.

Q. How much did you offer that to the public for?

A. I believe the price was \$36.00 a share. I would like to add one qualifying remark, however. The stock was listed on the New York Curb Exchange and was dealt in on the San Francisco Stock Exchange unlisted section, and had been selling for a higher price than \$36.00 per share.

Q. Isn't it a fact that you bought it for \$32.50?

A. I couldn't say the prospectus supporting that.

Q. If I show you the prospectus it probably will refresh your memory.

A. I think so. That is six years ago. That is correct; \$32.50.

Q. Isn't it a fact you paid \$32.50 for it?

A. It is.

Q. And you sold it to the public for——

A. \$36.00; that is correct.

Q. And at that time you had been advised by Mr. Paul Paine that the present worth of that was \$66.74 per share?

A. That is correct. And our purchase at \$32.50 was a matter of negotiation between the seller and the willing purchaser.

(Testimony of Ralph Phillips.)

Q. Well now, why didn't you reduce your present worth that you derived in Dominguez to conform to the so-called formula of Mr. Paine? [654]

A. Dominguez is a working interest.

Q. It is a working interest?

A. I say Dominguez Oil Field, Ltd., is a working interest, only it involves fractional royalties on several leases, whereas the Dominguez Estate Company is a proprietary interest.

Q. Well, that wouldn't make any difference; would it? A. It would to me.

Q. Would it really? A. Yes.

Q. Would it to Dean Witter & Company?

A. All I can say, Mr. Mackay, is I have been asked to make a report of what my firm would probably pay for these shares, and I have given you an answer.

Now, I don't propose to change that answer by your cross examination methods. I am telling you what I am prepared to state as a fact.

Q. Do you mean to tell this Court and to represent, in view of your testimony, that Dean Witter & Company would go out here and would have gone out and bought that stock in the Dominguez Estate Company at a value of—based upon the value of the oil wells at \$4,900,000.00 without getting an engineer to appraise it?

A. I am not asked to state that. I think we would have, yes. [655]

Q. This is purely hypothetical. Without getting an engineer?

(Testimony of Ralph Phillips.)

A. No, we would have relied on an engineer. I am given the facts the engineers would bring me; by stipulation I understand you have agreed these are the facts.

Q. Don't you understand in the Paul Paine reports I have referred to, he has given the per share worth and the stock was bought for less than half?

A. I understand.

Q. Wouldn't you follow the same procedure in buying Dominguez, as you would the oil fields, Dominguez Oil Fields?

A. No, we wouldn't. We would follow the same general formula. In calculating the present worth, we would divide by the number of shares to arrive at what we would pay for it. I gave you that figure.

Q. Did you take into consideration the fact there may be an earthquake and you wouldn't get all the income set forth in that exhibit?

A. Yes.

Q. What discount did you give for that?

A. None.

Q. Did you take into consideration that there may be a pro-ration of oil and restriction on production?

A. That has no part of that, if you let me answer that, because you have stipulated these will be the returns by years; [656] whether they are pro-rated or not is not a part of my consideration.

Mr. Melville: If your Honor please, the Petitioner hasn't established the market conditions for stocks and bonds in 1938 are comparable to the

(Testimony of Ralph Phillips.)

market conditions in 1941. I think he has gone far enough with this line of cross examination.

The Witness: I just saw this stipulation just yesterday. I have looked at it once. If you are going to ask me questions concerning it, I would like to refresh my memory.

By Mr. Mackay:

Q. You can take all the time you want. Will you please refer to page 5?

A. (Witness complies.)

Mr. Melville: Your Honor, I might state at this time I am going to object to the further continuance of this line of cross examination, until the Petitioner has established that there is any direct relation between market conditions in 1938 and 1941.

Mr. Mackay: If your Honor please, I am not here to try——

The Court: I don't seem to have any question before me that needs to be ruled upon at this time, gentlemen. I will hear your objections whenever they are made, and you may proceed with the cross examination, Mr. Mackay.

By Mr. Mackay: [657]

Q. Have you read K?

A. I am reading K. Yes.

Q. Now, did you understand that the stipulation merely said that Joint Exhibit 11-K is the estimated amount in barrels of oil of ultimate probable future production?

(Testimony of Ralph Phillips.)

A. If you will allow me, on line 21 it says, "Joint Exhibit 11-K (2) is a computation, based upon said Joint Exhibit 11-K (1) and upon an agreed price per barrel of oil, said price being net revenue per barrel of royalty oil received from January 1, to May 31, 1941."

I only have valued the dollar figures as presented to me by the Respondent. I have taken into account at no time the amount of barrels to be received.

Q. Well, I know, but——

A. I stated that in the beginning.

Q. Joint Exhibit 11-K——

A. I do not have those exhibits before me, so I don't know what they say.

Q. Do you want them?

A. I would like to see them.

Q. You were furnished with copies of all these exhibits; were you not? A. No.

Q. You weren't?

A. What I used was Joint Exhibit—or the summarization [658] of Joint Exhibit 11-K (2), which is calculated in dollars, not barrels.

Q. Now, you are familiar with the statement there, "Joint Exhibit 11-K (2) is a computation, based upon said Joint Exhibit 11-K (1)——"

A. I have read that after having prepared my estimate. My Estimates were completed before I ever saw that stipulation. But I did have, as I stated to you a moment ago, a summarization of the results of Joint Exhibit 11-K (2) and that is all.

(Testimony of Ralph Phillips.)

Q. Well, but when you read K (2), Joint Exhibit K (2) you weren't familiar with Joint Exhibit 11-K (1)?

A. I had never seen it at the time I made my computation.

Mr. Melville: I might add, for the record, the Respondent hadn't, either, at that time.

By Mr. Mackay:

Q. Now, do you mean to tell the Court, Mr. Phillips, that your company would buy oil properties, oil royalties without investigating the daily average production of the wells?

A. No, we would not.

Q. Nor would they buy oil properties without a pretty good estimate of the number of barrels to be recovered; would they?

A. I will go further than that. If it will interest [659] you, we wouldn't buy the oil royalties under any circumstances, without a competent engineer's full report on it.

However, if you will allow me to finish, I have assumed that after the engineer finished his report he would bring to us a dollar income figure for the years, and the rate would be spelled out in that dollar return, showing the curve as these figures do.

Q. Well, but suppose you had an engineer's report, with an estimate of the barrels and the estimate of probable future income?

A. That is what I had; without the barrels.

Q. If it were merely an estimate of future in-

(Testimony of Ralph Phillips.)

come, wouldn't you get somebody to look into that and see whether or not you wanted to pay the price for it?

A. Well, I think it has been made clear.

Mr. Melville: I object. He is asking this witness if he wants to disagree with the stipulated facts in this case. I see no reason why we should go back of the stipulated facts.

Mr. Mackay: I am not going back. I am just merely asking the witness if his firm would buy merely upon an estimate of future earnings, without considering——

The Witness: No. I understand these figures have been agreed upon by stipulation.

By Mr. Mackay:

Q. As merely estimates. [660]

A. As estimates; take it that way.

Q. Yes.

A. And that is all I prepared, was an estimate.

Q. I think you stated you had no experience in valuing oil royalties.

A. That is correct. I am not an engineer. I made that clear at the first. We know where to buy talent.

Q. If your firm was anticipating purchasing some oil royalties, would you give any consideration to the value of the oil in the ground?

A. Certainly.

(Testimony of Ralph Phillips.)

Q. What did that amount to in the Dominguez case, per share?

A. Do you refer to the Dominguez Fields, Ltd., Company?

Q. No, Dominguez Estate—that is right.

A. Which is it?

Q. I should have said Dominguez Oil Fields.

A. Well, according to our engineer's report it was approximately 41,272,470 barrels.

The Court: Should we go into that? Isn't that an entirely different setup?

Mr. Melville: Your Honor, I think I can explain the situation that is confronting Mr. Mackay.

Mr. Mackay: No, I don't think I want the explanation right now, Colonel. Thanks. [661]

Mr. Melville: You are welcome.

By Mr. Mackay:

Q. Did you check your result against any other forms of appraisal?

A. The result of what, my estimate here?

Q. Yes.

A. No, except to apply the same general practice of valuation that we believe to be sound.

Q. Well, do you think your firm would go out and make a big purchase like this without having it checked by someone?

A. I think so.

Q. They would have had somebody check it?

A. Yes, we would have had an engineer check it. You have developed that before, Mr. Mackay: I have answered that question twice.

(Testimony of Ralph Phillips.)

Q. What consideration did you give to the past earnings?

A. I looked at them.

Q. What consideration did you give to them?

A. I felt a 10 per cent return was adequate to get your money back, which is in part return of capital. If you will refer to your average earnings for the period preceding, as we do, you will find that they had paid in dividends something in excess of \$70.00 a share, or whatever it is. It is about a 10 per cent return. Perhaps my figures are at fault. I don't have them before me. [662]

Q. Are you talking about earnings or dividends?

A. Well, in a liquidating company they are generally the same. They are in the case of Dominguez Oil Fields, Ltd., which is one of your properties.

Q. The Dominguez Estate Company, do you think the earnings are the same as dividends?

A. Not necessarily. It all depends on the way they handle them.

Q. Have you considered the earnings?

A. Not very materially, no.

Q. You didn't give much thought to that?

A. Not very much, no.

Mr. Mackay: That is all.

Redirect Examination

By Mr. Melville:

Q. You made a comparison of the situation with respect to Kern County Land and the Dominguez Estate Company back in 1938 for the Petitioners'

(Testimony of Ralph Phillips.)

counsel. Would you bring that up to date and make a comparison as to the market value of Kern County stock in 1941, in relation to the appraised value of the assets? A. As of 1941?

Mr. Mackay: I object to that.

By Mr. Melville:

Q. Yes. Bring it up to date, to 1941. [663]

Mr. Mackay: I object to that as not proper redirect examination.

The Court: I doubt if it is proper redirect, Mr. Melville:

By Mr. Melville:

Q. Mr. Phillips, are you familiar with the market value of Kern County Land stock in 1941?

A. In general. I wouldn't trust my memory now to state what the exact quotations were; in general I can tell you.

Q. Have you ever had an occasion, in connection with your appraisal in this case, to check the relationship between the fair market value or the appraised value of the assets of Kern County—

Mr. Mackay: Which is it? I object to that.

The Court: Let's complete the question and we will hear your objection. Proceed.

By Mr. Melville:

Q. —with the market value of its stock in 1941?

Mr. Mackay: May I have the question, please?

(The question was read.)

(Testimony of Ralph Phillips.)

Mr. Mackay: I object to it, if your Honor please, as not proper redirect examination.

Mr. Melville: I think it is proper redirect, your Honor. They went into the situation in 1938.

The Court: Well, it doesn't seem to me that we are having much to do with Kern County real estate. I can't [664] see where it would be a proper part of redirect examination of this witness. We are not vitally concerned with the Kern County real estate or whether he made a good appraisal there or whether he didn't.

Mr. Melville: We are concerned, your Honor, with the appraisal methods of this witness. If after he has made his appraisal in this case he has compared it with the fair market value as established by the actual market of Kern County Land, which is a comparable company—both Petitioners' witnesses and ours have so testified—if he establishes by such a comparison that there is a direct relation between the fair market value of the stock of Kern County Land, as established by the actual market to its asset value, back of the stock, and that relationship is substantially the same as the relationship which he found in this case, it seems to me it would establish by an actual market that his methods are sound.

The Court: Well, it would be perhaps merely self-serving and his own opinion. At one time he made a good guess, and from that you are expecting us to assume that he is making a good guess this time.

(Testimony of Ralph Phillips.)

Mr. Melville: No, your Honor. He made no guess in Kern County. The buying public bought and sold Kern County stock.

The Court: Is it the essence of your inquiry now [665] as to whether or not this witness, in the light of his subsequent experience, feels that he was correct in evaluating the Kern County property?

Mr. Melville: He never evaluated the Kern County property.

The Court: What has the Kern County property got to do with it?

Mr. Melville: That is what I tried to point out a half hour before.

The Court: I have heretofore wondered what the Kern County property had to do with it.

Mr. Melville: If it had anything to do with it in comparing 1938 with 1941, then I submit that 1941, compared with 1941 is a fair question.

The Court: We will hear what he has to say on it.

(The question was read.)

The Witness: Well, my firm, aside from its initial purchase of the Kern County Land Company stock, has been called upon to make bids for substantial sums of it or quantities of it, I should say, from time to time, by people who wish to sell. In addition, there has been a regular over-counter market between dealers for the stock.

In 1939, which is the closest approximate date to the question date, we employed engineering counsel

(Testimony of Ralph Phillips.)

to appraise the oil values of the Kern County Land Company as of that date. [666] The methods used were quite comparable to the methods used——

Mr. Mackay: Your Honor, I object to that. We haven't got that report here.

The Court: Overruled. Let's hear his answer.

The Witness: The methods used were quite comparable to the methods used by Mr. Paine in valuing the Dominguez Oil Fields, Ltd., stock a couple of years earlier, or a year earlier, for us. Mr. Paine did not make that report, however. It was made by another engineer.

Mr. Mackay: I move that be stricken, if your Honor please; it is pure hearsay.

The Witness: It isn't pure hearsay.

Mr. Mackay: It isn't proper redirect examination.

The Court: Overruled. Proceed with the answer.

The Witness: It is my recollection and I don't have the report before me, either. It is my recollection that the value of the oil alone fairly represented the full price of the stock as indicated by market quotations at the time. In addition, there were other assets. There was land and cattle and a good deal of cash and the equivalent of cash. But taken on the basis of the large number of shares outstanding, I would guess that the other assets did not contribute very much per share to the total valuation of Kern County Land stock.

The primary factor was that of oil interests. But the market value, the oil at—approximately all of

(Testimony of Ralph Phillips.)

the oil [667] that was apparent by these reports.

However, there was much exploration being conducted at the time and there was an unknown factor which the engineers chose to place some rather nominal value upon, that is, for future discoveries. And therein the parallel did not appear to be quite the same as in this instant case. Does that answer your question?

Mr. Mackay: I move that be stricken as all hearsay; incompetent, irrelevant and immaterial.

The Court: I think it has very little probative value. It isn't altogether hearsay. We will let it stand for whatever it may be worth.

By Mr. Melville:

Q. Mr. Phillips, will you read into the record, please, the entire formula that Mr. Mackay went into on his cross examination?

Mr. Mackay: In what?

Mr. Melville: From Mr. Paine's report.

The Court: Let's hear that question again.

(The question was read.)

Mr. Melville: I withdraw that question.

By Mr. Melville:

Q. Are you familiar with the general market conditions as revealed by the Dow Jones averages or by other measures in 1938, as compared to 1941?

A. I wouldn't trust my memory, but I believe that in 1938 the market was reflecting a rather poor year for industry. 1937 was a very good year. 1938 was a rather poor year. It was a mild re-

(Testimony of Ralph Phillips.)

currence of the depression. In 1941 we were well on our way toward the war stimulus which later affected the market. While I say I would not trust my memory, it is my belief that the Dow Jones averages were at least 10 per cent higher than they were in 1938.

Q. Mr. Phillips, with the kind permission of opposing counsel, will you state, in connection with your qualifications, what the National Association of Securities Dealers, Inc., is, and what your connection with that Association is?

A. The National Association of Securities Dealers, Inc., is a voluntary association composed of practically all of the people in the securities business, created by an Act of Congress known as the Maloney amendment to the Securities and Exchange Act of 1934. That amendment provided for regular self-regulation on the part of the dealers and others engaged in the business. And, as I have stated, practically all the people in my business are members of that Association.

Q. What is your position with that Association?

A. Currently I am chairman of that Association's board of governors.

Q. Is that the head of it? A. Yes, sir.

Mr. Melville: No more questions.

Recross Examination

By Mr. Mackay:

Q. You said, I think, in 1941 we were pretty well on our way to war stimulus.

(Testimony of Ralph Phillips.)

A. Perhaps you quarrel with the term "war-stimulus."

Q. I am not quarreling with anything. I am asking you a simple question.

A. I stated so, yes.

Q. At that time, wasn't there quite a stimulation for increased taxes?

A. I believe that a defense tax of 10 per cent had been added to the general corporate taxes at that time. We were not yet in war, unless you refer to the very last few weeks of 1941.

Q. No, I am referring to June 5, 1941.

A. The tax structure at that time was a matter which can be demonstrated. It included, as I recall, a defense tax, so-called, of 10 per cent.

Q. Weren't there a lot of statements being issued that would indicate that the taxes were going to be greatly increased immediately?

A. There are a lot of statements currently they are going to be immediately decreased; it hasn't occurred.

Q. I asked you if it wasn't at that time. I know what is going on at this time. [670]

A. I can't tell you what was going on at that time, except by hearsay.

Q. You take the Wall Street Journal?

A. Yes.

Q. Look at this (indicating). This is the San Francisco-Los Angeles issue for June 5, 1941. You read this every morning?

A. Sometimes.

(Testimony of Ralph Phillips.)

Q. It says: "Defense Outlays to Tax \$1 Billion a Month Soon.

"June, May Pass \$900,000,000,000 Figure.

"Excess Profits Tax Bill Modeled on Present Act Assured by Vote of Committee; Rates to be Stiffer."

A. I can read it.

Mr. Melville: Would you like to put the whole copy in?

Mr. Mackay: Do you want it in?

Mr. Melville: I don't care.

Mr. Mackay: Put it in if you want it.

By Mr. Mackay:

Q. If you expected a war stimulus or some stimulus from business, didn't you or Dean Witter expect quite a stimulation in the amount of taxes to be imposed? A. It might have followed.

Q. It was reasonable to expect taxes to go up after these statements; wasn't it? You are influenced by the Wall [671] Street Journal, aren't you?

A. Not very much. I read it factually, not for opinions.

Q. Realizing there was going to be a war and that we had——

Mr. Melville: You are assuming. Anybody couldn't realize there was going to be a war in 1941; it wasn't a realization.

Mr. Mackay: I will withdraw that.

The Witness: If you would like me to withdraw that, I would be glad to.

(Testimony of Ralph Phillips.)

By Mr. Mackay:

Q. Let me ask the questions. You knew the Draft Bill had been passed and they were building up a strong Army?

A. I wouldn't trust my memory. I knew that happened at some time, but I don't remember the date; perhaps at that time.

Q. Dean Witter, trying to value the estimated income on June 5, 1941, wouldn't have Dean Witter given some consideration to the foreseeable increase in taxes at that time?

A. It might have borne some weight, but not any material weight. Taxes were already very high, Mr. Mackay. Not in the light of subsequent developments, you understand; in the light of what had been the tax rate up to that time. A 10 per cent addition to the tax caused every corporation executive [672] in the country to scream; he was very unhappy about it.

Q. That is quite right. That had quite an effect upon the stocks; didn't it?

A. I don't believe it did.

Q. You don't believe so?

A. No, I don't believe so.

Q. You didn't take into consideration any expected rise in taxes when you arrived at your value, did you?

A. No. I took the existent rates as of that date.

Q. Who gave them to you?

A. It is a matter of record.

(Testimony of Ralph Phillips.)

Q. Who gave them to you?

A. I looked them up. No one gave them to me. I looked them up. I will spell them out for you, if you wish.

Q. You are very helpful.

Mr. Melville: He certainly is.

Mr. Mackay: That is all.

The Court: Is that all from this witness?

Mr. Melville: Just a moment, your Honor. No more questions.

The Court: You may stand aside, Mr. Phillips.

(Witness excused.)

Mr. Melville: I will call Mr. Gally.

I again make the offer, your Honor, in view of the fact that the exhibit goes through this detail and sets forth [673] the method used by this appraiser.

The Court: He has told us what it all is. I don't particularly care if you want it in evidence. I don't see where it is particularly helpful.

Mr. Melville: If it wouldn't help your Honor, it certainly wouldn't help anyone else.

The Court: It is just arithmetic of it. He has already told us in the testimony what he did.

Mr. Melville: Very well, your Honor.

JOHN GALLY

called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

(Testimony of John Gally.)

Direct Examination

The Clerk: Your full name for the record, please.

The Witness: John Gally.

By Mr. Melville:

Q. Mr. Gally, what is your business?

A. I am a customer's broker.

Q. How long have you been engaged in that business? A. About seven years, now.

Q. Would you please state for the record your educational and professional qualifications?

A. Educational first?

Q. You may refer to any notes you have. Yes.

A. It is simply a matter of dates. I was first interested in economics in London in 1911 to 1913 at Birkbeck College, and also at Polytechnic in London; I took a course in finance.

Then I came back to Wall Street in 1918 after the war and became a partner in T. L. Sexsmith & Company. I am skipping a few years just to make it easier to make progress. That firm was a member of the Consolidated Stock Exchange.

Then I became a partner of the firm of P. F. Cusick & Company, members of the New York Stock Exchange.

In 1923 I came out to California on account of my wife's health and founded a magazine and also purchased a magazine on finance; one was known as "Finance & Trade," a weekly; the other was the

(Testimony of John Gally.)

"Magazine of Western Finance." I also had an insurance publication which I purchased, known as "The Adjuster." I sold out these publications in 1928.

Of course, I also owned other financial publications, such as "The Pocket Manual of Western Securities," which was published in Los Angeles and San Francisco. I also ran "Gally's Financial Service."

Then I had an investment counsel license from the Corporation Department for eight years. And that brings me up to date to the customer's broker business, which I entered in 1938, with the Bank of America.

Q. Do you have any other qualifications which you wish [675] to state? Does that complete your list?

A. Except that I handle the accounts of a number of clients who are interested in oil securities and many other types of securities.

Q. Have you had experience in appraising oil royalties? A. I have.

Q. Would you briefly state that?

A. In trading in oil royalties we are called upon to make an offer or bid on securities that come over the counter. I have nothing to do, of course, with the listed oil royalties which are traded in the usual manner on the various exchanges.

Q. Are you speaking now of the securities or stocks of oil royalty companies or the oil royalties themselves? A. The oil royalty stocks.

(Testimony of John Gally.)

Q. Have you ever had any experience in appraising the oil royalties themselves?

A. I have not.

Q. Are you familiar with the yardsticks which are used by the buyers and sellers in measuring oil royalties which are bought and sold?

A. I am.

Q. Are oil royalties bought and sold between common laymen, just like laymen buy stocks and bonds? A. They are. [676]

Q. Does each buyer and seller have oil securities at the time the trade is made, have before them a complete engineer's report as to the oil properties back of the oil royalties?

Mr. Mackay: I object to that as a leading question.

The Court: Objection sustained.

By Mr. Melville:

Q. On what basis, Mr. Gally, do buyers and sellers deal in oil royalties?

Mr. Mackay: I object to that as incompetent, irrelevant and immaterial.

The Court: If he knows he may answer.

The Witness: As a matter of practical basis we evaluate oil royalties on so many times earnings of the past year for which a definite record is obtainable.

By Mr. Melville:

Q. How many times earnings is accepted as sound?

(Testimony of John Gally.)

A. If the royalty has many years to run, depending, of course, upon the length of time the wells have already run, and the nature of the field and various other conditions, such as comparisons of other wells in that field, we estimate from eight to ten times, a fair number of times last year's earnings, for the evaluation of those oil royalties.

Q. What is that figure you use?

A. I use eight as my figure. [677]

Mr. Melville: Did opposing counsel state he wanted a short recess?

Mr. Mackay: Yes.

The Court: We will suspend at this time for a short recess.

(A short recess was taken.)

The Court: You may proceed, gentlemen.

By Mr. Melville:

Q. Mr. Gally, have you seen and studied the stipulations of fact and exhibits in this case?

A. I have.

Q. Have you been furnished with copies for your retention and use of such exhibits as you felt you wanted in order to arrive at an opinion of the fair market value of the stocks of the Dominguez Estate Company, Francis Land Company, and Carson Estate Company as of June 5, 1941?

A. I have.

Q. On the basis of the stipulation and all of the exhibits, have you formed an opinion as to the fair

(Testimony of John Gally.)

market value of those stocks as of that date?

A. I have.

Q. Will you please state, in your own words, what your opinion is and how you arrived at it?

A. May I refer to my notes?

The Court: Yes. [678]

By Mr. Melville:

Q. Yes.

A. In closely held corporations as these, I regard the fair market value of assets back of the stocks as being the best measure of their value. In addition to the actual assets which have been stipulated in this case, I had to estimate the oil royalty figures on the basis on which a high grade royalty of this kind would be figured by a practical broker or buyer or seller in the business. The balance of assets as stipulated in the figures I have received from the Government I find the total \$4,979,699.00, which, divided by the number of shares outstanding, would give a per share value of \$474.30. This figure, I understand, has been stipulated in the agreement that I have seen.

The oil royalties I have figured on the basis of the nearest possible market valuation I could find for a similar property, which I have found in the Dominguez Oil Fields Company, which is operating in the same field and has some of the principal oil leases the same as Dominguez Estate Company.

On the date in question, June 5, 1941,—By the way, I have obtained my information about the

(Testimony of John Gally.)

earnings of Dominguez Oil Fields from Walker's Manual of Pacific Coast Securities, page 992. I have obtained my market quotation on June 5, 1941, from the Wall Street Journal as of that date. Both of these sources have information I consider reliable [679] in our business.

The net earnings of Dominguez Fields, which I am using as a base for estimating the number of times earnings the comparable stock was selling for in the actual market on that date, I find that the nearest full year figures in Walker's Manual in 1941 covered the year 1940, and net earnings before depreciation and depletion amounted to \$1,460,-887.00.

This divided by the 400,000 shares outstanding at that time of Dominguez Oil Fields Company, multiplied by the actual bid in effect on that date of thirty for Dominguez Oil Fields stock, makes a total market value at the quoted price of \$12,000,-000.00. This equals 8.2 times earnings.

I might add there I looked up the quotations, the actual sales prior to—the only one I could find was on June 4th, the previous sale of 165 shares of Dominguez Oil, which sold on the San Francisco Stock Exchange that day at thirty, and that was the low for that week. The total quotations for the week were contained in the Monday summary of the Wall Street Journal on June 9th, which showed thirty and one-eighth high and thirty low and thirty last.

With that as a conservative base for estimating the oil royalties for Dominguez Estate Company, I

(Testimony of John Gally.)

find the per share valuation of \$387.16 for the oil royalties figured on the basis of 8.2 times 1940 earnings. Adding the figure of \$387.16 of the value, the fair market value of the oil [680] royalties, to the stipulated per share value of the Dominguez Estate Company, I obtain a total valuation of the Dominguez Estate Company stock on June 5, 1941, of \$861.46.

I might add here that I have figured the valuation of Dominguez Estate Company stock on another basis, which I will explain later on, as I wish to finish with Francis Land Company and the Carson Estate Company valuations on this basis first.

Francis Land Company, on the basis of the known assets as of June 5, 1941, showed 1 1/10th shares of Dominguez Estate in relation to one share of Francis Land Company. This is equivalent to 1/10th—to simplify the valuation—1/10th more than the value of the Dominguez Estate shown above, or \$86.16 added to the Dominguez Estate valuation gives me \$947.60 as my fair market valuation of Francis Land Company on June 5, 1941. This per share. [681]

The Carson Estate Company, on the same basis of known assets which have been stipulated on June 5, 1941, amounted to \$761,396.00 as the balance of assets after liabilities and other deductions, divided by the number of shares outstanding, which were \$7,412.00, making a stipulated value per share of Carson Estate \$102.72.

This figure, I understand, has been agreed to in

(Testimony of John Gally.)

the stipulation. I was confronted with valuing the oil royalties of Carson Estate on the same basis as I valued Dominguez Estate, but knowing that the properties from which the royalties of Carson Estate were derived were rather on the side than on the top of the oil structure, I figured a poorer percentage of times earnings, which, in my estimation, I placed at 6 times 1940 earnings, which gave me \$212.52 for Carson Estate Company oil royalty valuations.

The 1940 earnings I obtained from the Government stipulation or agreed to stipulation of earnings on Carson Estate in 1940 of \$35.42. The reason I took the per share earnings in all my calculations was to simplify the figures, and they were arrived at from the simplified figures that were shown in the stipulated dollars and cents reports.

In addition to the oil royalties and the asset valuation of Carson Estate, I had to consider the value of the Dominguez stock, which was held by Carson Estate at that time, and which I figured at \$143.00 per share—I have the figures [682] here to bear me out—and the per share value of Francis stock, which I have shown above at \$947.60 gives a per share value of the Francis holdings in the Carson Estate of \$234.00, making a per share value of the total known assets of Carson Estate Company of \$692.24.

Now, to these figures I might add the speculative possibility of discovering additional oil, either in deeper sands, if the company should decide to drill

(Testimony of John Gally.)

deeper in a couple of years, or in new structures which might be developed. I know of no way of measuring this speculative value, so I have added and did not consider them in my figures.

The other method of determining market values that are practically used in our business are also the basis of earnings or the basis of dividends. However, I might say that in applying the basis of earnings, my preference would be for capitalizing the assets, plus the valuation of oil royalties as I have done, rather than stipulating the market value on earnings alone. Inasmuch as these are family holding companies they have to distribute all earnings as dividends or suffer severe tax penalties.

It is, therefore, reasonable to assume—this is my opinion—that all earnings will be distributed as dividends, so that earnings and dividends are practically the same.

Another method that I might use, in bringing to the attention of the Court in market appraisal, is that of comparison. [683] We try to take companies of a similar nature or as closely as possible in the same industry, and derive from them as to what they were selling at that time, which in this case was June 5, 1941, in the actual market. And then by making those comparisons to the stock in question I try to arrive at a basis and give that as my figure.

On the basis of these comparatives, I have found that Kern County Land, which I also obtained the figures for in Walker's Manual, and the quotations

(Testimony of John Gally.)

from the Times, I have found that on June 5, 1941, the total market valuation of Kern County Land was \$45,250,000.00, on the basis of the latest statement available, which was that for 1940. And the market value on that date showed that that figure was 14.8 times earnings.

I took another company which was a little further away from a comparison, but it is the closest I could find, which was Los Angeles Investment Company. The figures I took from the same sources, and I found that their total valuation, according to the 1940 statement, was \$2,621,590.00, which was equal to 14.9 times earnings.

Having two of these similar companies as a basis for arriving at a number of times earnings, I figured that 15 times 1940 earnings would be as close as I can get as of June 5, 1941, comparative companies with which to measure Dominguez Estate, Francis Land and Carson Estate Companies. [684]

My figures on this basis are somewhat lower and amount to \$709.05 per share for Dominguez Estate; \$779.95 per share for Francis Land; and \$531.30 for the Carson Estate Company. While I think that the latter figures are not quite as specific or reliable, they are, in my opinion, a fair appraisal of market value on the basis of earnings.

The Court: Off the record.

(Discussion off the record.)

The Court: On the record.

The Witness: I, of course, have only one more

(Testimony of John Gally.)

comment to make, that in valuating securities, your Honor, I find actual sales wherever I can obtain anywhere near the period in question are always the best measure of what the actual market value is at that time. But we haven't been able to obtain these in this case, so I will have to rely on my figures obtained as I have obtained them from my three different methods of calculation.

By Mr. Melville:

Q. Mr. Gally, were you informed after you made your appraisal in this case that the parties had agreed and stipulated as to the fair market value of the oil royalties in the Carson Estate Company case at \$285,000.00? A. I have.

Q. Have you revised your appraisal accordingly?

A. I have, to this extent: That I have been confirmed [685] in my opinion in lowering the number of times earnings the oil royalties were figured at in the Carson Estate Company, as compared with the Dominguez Estate valuations. I figured 8.2 times for Dominguez and I figured only 6 times earnings for Carson royalties.

Q. On Carson royalties then at that basis, what was your total value for Carson royalties? Not per share, but total.

A. Total, yes. I am going to get that for you. Colonel Melville, I think I will have to multiply that. I see the figures here, but there are so many figures of mine to go through.

(Testimony of John Gally.)

The Court: What are your multiples?

The Witness: 6 times 35.42. I beg your pardon. 6 times \$262,528.07, which was the net income of the Carson Estate Company for 1940.

The Court: Very well. You may proceed.

By Mr. Melville:

Q. Mr. Gally, on your Carson Estate Company, with respect to your figure as to oil royalties figured on the basis of 6 times 1940 earnings,—

A. Yes.

Q. —if you were told that on the basis now of the new stipulation of facts as to two hundred eighty-five thousand for those oil royalties, it amounts to \$38.41 per share, how [686] much, if any, would that change your opinion?

A. As against thirty-five forty-two before?

Q. As against two hundred twelve fifty-two.

A. Oh, that would reduce my valuation of the oil royalties which I had figured before I had seen those stipulations by just that amount.

The Court: By the difference between two hundred twelve fifty-two and thirty-eight forty-one?

The Witness: Yes, your Honor.

By Mr. Melville:

Q. Will you carry through that computation?

A. I will. Thirty-eight forty, did you say, Colonel?

Q. Thirty-eight forty-one.

A. Thirty-eight forty-one. It is \$174.11, less

(Testimony of John Gally.)

than my figure, or instead of six hundred ninety-two twenty-four for Carson Estate, it would make my corrected figure \$518.13.

Q. Will you recheck those figures, please?

A. I will. Just a minute.

The Court: That is correct on the subtraction, as I make it.

By Mr. Melville:

Q. Now, Mr. Gally, do you consider an actual sale between a willing buyer and willing seller at a given price, does that indicate to you an indices of fair market value?

A. Absolutely. [687]

Mr. Mackay: I object to it as a leading question.

The Court: The question has been answered.

Mr. Mackay: I move it be stricken. I wish the witness to be instructed not to answer until I make my objection.

The Court: The answer may be stricken.

Mr. Melville: I will withdraw the question.

The Court: Very well.

By Mr. Melville:

Q. Mr. Gally, if a willing buyer, well and able to buy but under no compulsion to do so, and a willing seller, under no compulsion to sell but willing to do so, should make a deal whereby stock of a given company is bought and sold, would that or would it not indicate to you what the fair market value of that stock was?

A. It would be one——

(Testimony of John Gally.)

Mr. Mackay: Just a moment. I object to that as a leading question.

The Court: Well, we will hear him.

The Witness: It would be one method of arriving at a fair conclusion. I might add here, Colonel Melville, in all my experience I have found no one method that anyone can discover and say, "That is the only method," or the "only correct method of evaluating a security."

By Mr. Melville: [688]

Q. In your business what is the best method of evaluating a security?

A. I would say the best method is the actual sale, wherever it is obtainable, on that particular date. Where it is not obtainable, the next best method would be the consideration of the liquidating or book value, plus any other additional assets that might be valued for some future time ahead.

Third, the basis of number of times earnings, if it is a sufficiently seasoned security to enable one to have an active turnover of securities. And then measuring your yearly earnings against that market value of heavy turnover. This, of course, was not the case here. And, therefore, I did not use the pure earnings or pure dividend method of evaluation.

Q. Now, Mr. Gally, if you knew or if the evidence in this case establishes, before the trial is over, that there were actual sales made of Dominguez Estate Company stock at \$1,000.00 a share

(Testimony of John Gally.)

during 1941, would that change your opinion as to the fair market value of that stock?

A. It would. It would raise it to this extent: That I would allow a differential there of \$138.00 between my figure of \$861.00 of actual valuation, plus the \$138.00 to make up the \$1,000.00 asset value, and consider that \$138.00 per share as undeveloped oil or increase in possible price of oil over the next 10 or 20 years, which is very possible, or any deepening or changing of oil structures that we might discover in those [689] fields as drilling goes on.

Mr. Melville: Your witness.

Cross-Examination

By Mr. Mackay:

Q. You are not now connected with the Bank of America; are you?

A. No. I am with Fairman & Company.

Q. Fairman & Company? A. Yes, sir.

Q. You have seen the stipulation with respect to the income of Dominguez Estate Company for 1940, the earnings; haven't you? A. Yes.

Q. What figure do you use there as the earnings per share?

A. Per share I used \$47.27.

Q. Did you consider that in your valuation of the Dominguez Estate Company stock?

A. I did.

Q. If you take 8 times 1940 earnings for the value of the stock, what would that be?

(Testimony of John Gally.)

A. That would be 8 times \$496,281.00. I could multiply it here or figure it out.

Q. Isn't it 8 times forty-seven?

A. Per share? [690]

Q. That is what I am talking about.

A. Yes.

Q. That will give you 377——

A. .2. I beg your pardon. I have taken 8.2 because I obtained that figure of 8.2 by taking Dominguez oil fields as my basis for calculation, which I figured was a very close analogy.

Q. If you multiply those earnings by 8.2, what do you get? A. You get \$387.16.

Q. As the value of the stock?

A. As the value of the oil royalty portion of that stock.

Q. As the value of the oil royalty portion of that stock? A. Yes, sir.

Q. Then you took the stipulated earnings from all sources? A. Yes.

Q. As the basis for the valuation, and multiplied that by 8? A. Yes, sir.

Q. And you said that was the value of the oil royalties? A. Yes, sir.

Mr. Mackay: That is all. [691]

The Court: Let me ask the witness one question. I have here, as I recollect your testimony, three or four different figures for each block of stock, indicating the mathematical results from applying a particular yardstick. Do you, from an analysis of all these exhibits, and a consideration of all of these

(Testimony of John Gally.)

various yardsticks, have any specific amount that you would consider to be the fair market value of the stock, on the basic date, considering fair market value to mean, as no doubt what it means,—

The Witness: Yes, sir.

The Court: —the price at which the hypothetical willing buyer, having knowledge of all of the facts, and the seller, having knowledge of the facts—neither being under any compulsion—would trade? In other words, can you summarize your testimony to give me the figure for each of the shares upon which you rely or which you accept as the fair market value?

The Witness: I would take my first method that I outlined which—

The Court: Just answer the question. What are the figures you give me as your fair market value?

The Witness: I would give you \$861.46 for Dominguez Estate; \$847.60 for the Francis Land Company; and \$518.13 for the Carson Estate Company.

The Court: Very well. [692]

Mr. Melville: No more questions.

Mr. Mackay: That is all.

(Witness excused.)

Mr. Melville: Mr. Grimes, take the stand.

JOHN ALDEN GRIMES

called as a witness by and on behalf of the respondent, having been first duly sworn, was examined and testified as follows:

(Testimony of John Alden Grimes.)

Direct Examination

The Clerk: Your name for the record, please?

The Witness: John Alden Grimes.

By Mr. Melville:

Q. Mr. Grimes, will you state your educational and other qualifications?

A. I graduated in 1908 from the Minnesota School of Mines, Degree of Mining Engineer. I attended the Columbia University in New York for the next two years, taking graduate courses in geology, mining and metallurgy.

I completed all of the residence requirements for a Ph.D. degree, but stopped school to go to work for the Anaconda Copper Mining Company in their geology department in Montana, before writing many dissertations and so forth. I have no graduate degrees. I worked in the geology department of the Anaconda Copper Mining Company from July 5, 1910, until January, 1920. [693]

I entered the employ of the Bureau of Internal Revenue on January 15, 1920, as a valuation engineer and have been the valuation engineer in that organization since that time, specializing at first in the valuation of natural resource properties, principally mines, non-metallics metal deposits; later on depreciation studies under the Assistant Commissioner and Deputy Commissioner; and since 1928 in the office of the Chief Counsel of the Bureau of Internal Revenue on various valuation matters,

(Testimony of John Alden Grimes.)

principal of which have been the valuation of closely held stocks.

Q. Were you present throughout the trial of this case?

A. Yes, I have been in attendance throughout the whole trial.

Q. You heard the testimony of Mr. Wents?

A. I have.

Q. Have you made a computation to determine the percentage of yield which would result from Mr. Wents' valuation?

A. I have.

Q. What did you find out?

Mr. Mackay: I object to that, if your Honor please. It is in evidence there. We can make a computation in the brief. There is no use taking the time of the Court now.

The Court: We will hear him. He may tell. You may answer.

The Witness: 18 per cent rate of return after taxes [694] at rates in effect in 1941. And in addition to the return of the value to which Mr. Wents testified, namely, \$2,701,361.00.

Mr. Mackay: What was that?

The Witness: \$2,701,361.00.

By Mr. Melville:

Q. Do you have a chart showing this computation?

A. I have.

Q. Just what does that 18 per cent mean now?

A. That is 18 per cent interest compounded annually. That is for a seven-months period in the

(Testimony of John Alden Grimes.)

year 1941, from June 1st to December 31st, and one year additional discount for each successive year.

Mr. Melville: May I have that marked for identification?

The Court: It may be marked for identification as Respondent's Exhibit GG.

(The document referred to was marked as Respondent's Exhibit GG, for identification.)

Mr. Melville: I offer this computation in evidence as Respondent's Exhibit GG.

Mr. Mackay: If it goes in just for explanatory purposes I don't mind. As to proof of value here, I think it is objectionable. I object.

Mr. Melville: It is not intended, I also stipulate it is not intended as proof of value. We don't agree with the [695] value Mr. Wents testified to. It is simply to show that Mr. Wents' testimony would contemplate the return of about 18 per cent on one's investment after taxes and so forth.

Mr. Mackay: If it is for that purpose I object to it as incompetent, irrelevant, and immaterial.

Mr. Melville: O.K. I will withdraw it, your Honor. I don't think it makes any difference.

The Court: We will receive it for a limited purposes.

(The document referred to, heretofore marked as Respondent's Exhibit GG, for identification, was received in evidence as Respondent's Exhibit GG.)

(Testimony of John Alden Grimes.)

By Mr. Melville:

Q. Mr. Grimes, are you familiar with the facts disclosed by the stipulation? A. Yes, I am.

Q. Have you made an investigation to ascertain whether or not there was a public market for stocks of similar companies?

A. I made a very exhaustive examination of all royalty companies in which class I consider all of these three companies.

They derive their principal income from oil properties. I maintained lists of companies in different branches of industry beginning with 1928, and I have added to those from [696] time to time. In connection with this particular study I had pages of national stock summary. I turned it over page by page and got the names of all the royalty companies there. I looked all of those up in Poor's Manual or Moody's Manual, in addition to the companies for which I already had names. I compiled as complete information as I could upon the earnings, market quotations, and so forth for all oil royalty companies, stocks of which were bought and sold by the public and quoted in public records.

I found 23 oil royalty companies for which I could get both earnings and stock quotations, although two of those 23 companies I could only get preferred stock quotations, so there are 21 companies for which I could get both common and preferred stock quotations, if both classes were out-

(Testimony of John Alden Grimes.)

standing. I think those 21, though, had only common stocks outstanding.

Q. Based oupon the stipulated facts and upon your investigation of the market for stocks of similar companies, have you been able to form an opinion as to the fair market value per share of common stock of Dominguez Estate Company as at June 5, 1941?

A. I have on the basis of companies that I consider comparable to Dominguez Estate Company.

Q. What, in your opinion, was that value?

Mr. Mackay: I object to that, if your Honor please, unless he first shows what comparisons were made. [697]

The Court: Well, do I understand that that is what the witness is now going to relate, its comparative values with other companies?

The Witness: Yes. That is a statutory requirement.

Mr. Mackay: I will withdraw the objection.

By Mr. Melville:

Q. You may answer.

The Court: Very well. You may answer.

The Witness: I valued the stock of Dominguez Estate Company at \$933.31 per share as of June 5, 1941.

Mr. Mackay: Repeat that figure.

The Court: Let's have the amount again.

The Witness: \$933.31 per share.

(Testimony of John Alden Grimes.)

By Mr. Melville:

Q. Would you explain the processes by which you formed that opinion?

A. First it was necessary to ascertain what income the Dominguez Estate Company got from oil royalties. I did that by an allocation of unallocated income.

Now, there were two items of that. One was total general overhead expenses not allocated to any particular phase of the business, and the other was total taxes that were not allocated to any specific phase of the business.

The stipulated income of the Dominguez Estate Company from 1940, from all oil royalties, was sixteen hundred six ninety-four [698] before an allocated overhead and expense and capital and franchise taxes.

The unallocated general expense was \$85,507.05, and the income in other unallocated taxes amounted to \$83,896.24 in 1940.

I might explain, before proceeding further, that I consider the latest full year's income to be the best basis for comparison between one company and another. So that I have used 1940 income throughout, that being the last published figure for any of the companies available at June 5, 1941.

Now, there is very little overhead expense in my opinion in the collection of oil royalties. And practically all the company's overhead expenses should be attributed to its other activities in 1941. Those

(Testimony of John Alden Grimes.)

other activities produced only \$54,967.96 before overhead expense income and similar taxes, and that income is \$34,549.09, less than the unallocated general expense of the company. So I have allocated \$34,549.09 of this general expense against oil royalties, and I regard that as a very high figure but it simply means there was not any income from the other activities of the company with which to pay that expense. I considered it properly should be allocated to oil royalties on that account.

That means I allocated the entire taxes of the company that are not directly placed on specific items of property, those of income and franchise and capital stock taxes. I [699] allocate all of those as an expense of the oil royalty phase of the business.

With the figures I have given before, \$616,797.98 income from oil royalties, less \$83,896.24 for income and similar taxes, and less the \$34,549.09 of general expense which I have allocated to the oil royalties, I had a remaining \$498,352.65.

Now, that is the entire net income of the company for 1940, plus \$2,071.18, which the company deducted for cost depletion as shown in this stipulation. Therefore, I considered that this income of \$498,352.65 was the net income after taxes, which the company realized from oil royalties in 1940.

I have the information as to the other oil royalty companies, and I found that companies I considered reasonably similar were selling for—six oil royalty companies, whose stocks were traded in California

(Testimony of John Alden Grimes.)

markets were selling for 9.82 times their 1930 earnings, before depletion, but after taxes. I found there were six other——

The Court: Do you mean 1930 or 1940?

The Witness: 1940. I found that six other oil royalty companies with stocks traded on stock exchanges outside of California were selling for 9.67 times their 1940 earnings. Those were very close together.

Mr. Mackay: Pardon me. I didn't get that last.

The Witness: Those two ratios, the 9.82 and 9.67 were very close together. I took the lower of the two, 9.67. That only accounts for 12 of the 23 companies in the oil royalty business, for which I found published figures I regarded as sufficient to make comparisons with four companies which had rather diversified interests out of oil royalties. They had large land ownerships principally.

Since I am only valuing the oil royalties of Dominguez Estate Company on this basis, I did not take those companies with diversified activities, because that did not give me a multiplier for the oil royalties; four were eliminated for that reason. The other seven were very small, comparatively marginal companies, and I did not consider they owned as assets, or would be held in the same public esteem at all with either the Dominguez Estate or Francis, which derives its income indirectly from the same oil royalties, or Carson, which derives most of its income from the same oil royalties, plus a few additional.

(Testimony of John Alden Grimes.)

So I eliminated both the four companies which were selling on the basis of 15.96 times 1940 earnings and I have eliminated the seven which were selling on the basis of 3.72 times the 1940 earnings. I made the comparison on the basis of the other 12 companies, taking the lower of the two figures, 9.67 times earnings.

I might say I have copies of comparative information I used here. The first page is a summary and each succeeding [701] page is a detail for the one group of the four groups into which I have divided them. Then the last sheet attached to the back is a list of companies for which I could not get adequate information. That is the complete list of companies which I examined.

By Mr. Melville:

Q. How many copies do you have?

A. I have three here. I have work sheets, too, I think.

Now, my comparisons are made on the basis of net income before depletion, but after taxes, in all cases and the four hundred ninety-eight thousand odd dollars of Dominguez income, which I have stated in my opinion came from oil royalties, was multiplied by 9.67 times earnings to value the royalties of Dominguez estate. On that basis I got a value for the royalties of \$4,810,070.13. I am carrying these out to cents, not because I believe the appraisal is anything like that accurate, but simply

(Testimony of John Alden Grimes.)

because I have other cents in the stipulated figures to add in, and make any adjustments——

Mr. Mackay: Give me that figure again.

The Court: It might be easier to keep them in the record and easier for folks to copy them down if you just threw away the cents and eliminated them altogether from the record, Mr. Grimes.

The Witness: I would be very glad to do that, because [702] appraisals are made in no such accuracy as that. It is just a method of computation, and I wanted to show the method.

The Court: I think if you just eliminate your cents, it is easier for anyone trying to copy them down, including the reporter. Let's throw the cents away.

The Witness: Those total figures I gave may not add up to dollars.

The Court: All right. We will understand.

The Witness: The stipulated value of the other assets was added to that figure to give \$9,798,769.00 for 10,499 shares of stock, or \$933.00 per share of stock.

I consider that to be an asset value simply for known assets, and I consider the company has some assets which it is impossible to value, that are too speculative and intangible, but might have a value to the owner or a possible buyer. But they are not the type of assets I would feel competent in any way to place a value on.

I might point out also that the stock prices upon which these purchases are made are the prices of

(Testimony of John Alden Grimes.)

minority interests of these companies. They are not large blocks, but minority interests that are generally traded by the public. Should I go on to the other companies? That was an asset valuation for Dominguez. I did not consider that the company, as a whole, should be valued on any earnings basis when it had practically \$5,000,000.00 of assets which, in my opinion, were [703] not producing any income at all in the aggregate.

It is obviously impossible to value any asset which is losing money on an earnings basis, and it is equally impossible to value an asset which is merely breaking even on an earnings basis, so that I saw no possibility of valuing those assets upon any earnings basis.

Since I have valued the royalties upon an earnings basis and would have to use the other assets at book value, I would get exactly the same answer on an earnings basis I would on an assets basis for the stock of Dominguez Company.

On a dividend valuation—this is personal holding company filing income tax returns as such—and it either must pay out all of its earnings as dividends, or it is going to have to pay a severe penalty tax. I, therefore, assumed the company would do the reasonable thing and pay out its earnings as dividends and that any valuation on the dividends basis would be identical with that on the earnings basis. I think that is all as regards Dominguez.

The Court: I think then we will suspend at this time. It is probably a good place to quit.

Mr. Mackay: Thank you, your Honor. I am pretty tired, myself.

The Court: We will suspend until 9:30 tomorrow morning.

(Whereupon, at 4:30 o'clock p.m., a recess was taken until 9:30 o'clock a.m., Saturday, October 13, 1945.) [704]

PROCEEDINGS

October 13, 1945, 11:00 a.m.

JOHN ALDEN GRIMES

recalled as a witness for and on behalf of the Respondent, having been previously duly sworn, was further examined and testified as follows:

Direct Examination (resumed)

By Mr. Melville:

Q. Mr. Grimes, did you finish your explanation of how you arrived at the value or your opinion of the value of the stock of the Dominguez Estate Company? A. I think so.

Q. Do you have an opinion as to the June 5, 1941 value per share of stock of the Francis Land Company? A. I have.

Q. Will you please state that opinion and how you arrived at it?

A. My opinion is that the value of a share of the Francis Land Company stock on June 5, 1941 was 1.1 times the value of a share of Dominguez

(Testimony of John Alden Grimes.)

stock on the same date. The company had current liabilities a few cents in excess of total assets, other than Dominguez stock, which I am disregarding. I am also disregarding the seven thousand a year expense, overhead expense and taxes of the Francis Land Company in arriving at that opinion. I disregard the expense of operating the company, because it was a company which, in my opinion, had [709] no useful reason for its existence in the family setup of corporations. If the stockholders chose to continue to keep this company in existence, the benefits which they derived from that or would derive from maintaining the corporate existence of the Francis Land Company would counterbalance the cost of maintaining that existence. It was a family holding company, classed as a personal holding company in tax returns, the same as Dominguez Company, which derived almost its corporate income from the Dominguez Company. It had to pay out that income in dividends or suffer penalties the same as Dominguez. So that I would value the Francis Land Company on the same basis as Dominguez as to earnings and dividends and arrive at the opinion that it should be valued according to its asset value. That, I think, is all I have to say on Francis.

The Court: You didn't give the figure. That amounts to some \$1,026.00, is that right?

The Witness: Yes, probably. I didn't write those up.

(Testimony of John Alden Grimes.)

The Court: Well, you said 1.1 times the \$933.31, is that right?

The Witness: Yes.

The Court: Very well.

By Mr. Melville:

Q. What is that, Mr. Grimes? [710]

A. Well, I should have to compute that figure in terms of——

Q. What value did you state as to Dominguez Estate Company Stock? A. \$933.31.

Q. And did you say Francis was worth 1.1 times that? A. Yes, one and one-tenth.

Q. That would make how much?

A. \$1,026.64.

Q. Now, Mr. Grimes, do you have an opinion as to the June 5, 1941 value per share of the Carson Estate Company?

A. Yes, I would simply substitute these values of the Dominguez and Francis Stock in the Carson balance sheet, and at \$933.31 for Dominguez on 1353 shares and 1785 shares of Francis at \$1,026.64, the value of all of their assets as stipulated, divide that by 7,512 shares and it gives the value per share, for the same reasons that I evaluated the stock of Francis and Dominguez on the basis of being oil royalty companies and using the stipulated figure of \$285,000.00 for the value of the royalties. That is for Carson.

The Court: I was just going to ask the calcula-

(Testimony of John Alden Grimes.)

tion. What does that bring you to? I haven't worked it up.

The Witness: I haven't either, but I will work it out. [711]

The Court: Well, we won't take time now. You may proceed.

The Witness: There is just one further observation with respect to Carson. It was operating at a loss as far as all of its assets were concerned, outside of the stocks of Francis and Dominguez and its oil royalty interests. The other assets were all producing no income, and in fact, operating at a loss, and those assets could only be valued, in my opinion, upon the basis of their stipulated fair market values.

By Mr. Melville:

Q. Now, Mr. Grimes, with respect to your opinion as to the value of the stock in each of these companies as of the basic date, I *would to* know if you gave consideration to income tax in formulating your opinions of value? A. Yes, I did.

Q. Did you give consideration in each case to the size of their holdings? A. Yes.

Q. Did you in each case give consideration to the marketability of the stock in question?

A. Yes.

Q. Did you in each case give consideration to the fact that the three companies were personal holding companies or family corporations? [712]

A. Yes.

(Testimony of John Alden Grimes.)

Q. Did you in each case consider methods other than the one you used when formulating your opinion as to the value of the oil royalties assets of the Dominguez Estate Company?

Mr. Mackay: I object to the question as leading, and if your Honor please, that has all been leading.

The Court: Overruled. Let him answer.

A. Yes, we consider other methods.

By Mr. Melville:

Q. Did you consider the payout method?

A. Yes.

Q. Did you consider percentage of volume?

A. Yes.

Q. Did you consider the daily barrel method?

A. Yes.

Q. Does the daily barrel method have an appropriate application in this case, in your opinion?

A. No.

Q. Why?

A. The daily barrel method is a very elastic yardstick. It was used in the early days of the oil industry, and would apply principally to the valuation of an individual oil well, computing an interest in that or computing the whole oil well, and the price would vary considerably. I [713] believe Mr. Paine's book gives a range of 400 to 2500 dollars per barrel of daily production, which is a very elastic yardstick. Applying it between properties with a great number of wells or properties in different states of development, I don't

(Testimony of John Alden Grimes.)

believe it is applicable at all. It is not applicable for another reason, that if a property is capable of producing a thousand barrels a day, but by curtailment it only produces 500 barrels a day, this daily barrel production business obviously does not apply to such an oil well.

Now, if you have a property which is fully developed and in which production is going to decline in the future, you would get a yardstick there which would be impossible to apply to another property which had new sites to drill wells and from which an increase in production rather than a decrease could be expected in the immediate future years.

Particularly with respect to curtailment, you could not use the yardstick of price per barrel of daily production from a pumping well and apply that to a flowing well, because it is my understanding that there was no curtailment of production with respect to pumping wells and there was curtailment of production with respect to flowing wells, that all of the curtailment of production which was in effect applied simply to flowing wells.

Q. Did you consider the present worth method when evaluating the oil royalties of Dominguez Estate Company? [714] A. Yes, I did.

Q. Did you consider the sales of comparable royalty interests in reaching your opinion as to the value of the oil royalties in the Dominguez Estate Company?

Mr. Mackay: I object to that, if your Honor

(Testimony of John Alden Grimes.)

please, unless they specify what the comparisons are based upon. It is a leading question.

The Court: The question was rather general, don't you think, Mr. Melville?

Mr. Melville: Perhaps so, your Honor.

The Witness: I think I could answer that in a way which would not embarrass Mr. Mackay at all.

Mr. Mackay: It is not a question of embarrassing Mr. Mackay. It is a question of competency. Has the Court ruled on that?

The Court: I understand so. I thought I had. Perhaps Mr. Melville was going to rephrase his question.

Mr. Melville: I will attempt to do so, your Honor.

The Court: Very well.

By Mr. Melville:

Q. Do you have knowledge, Mr. Grimes, of any specific sales of oil royalty interests in the Los Angeles area at or about 1941?

A. The only sale that I was able to find was a sale of [715] a large royalty interest—for at least five years prior to June 5, 1941—a Grubb sale of royalties and the Taylor lease to the Shell Company, concerning which Mr. Pemberton already has testified.

Q. Did you inquire into the facts with respect to that sale? A. Yes.

Q. And did you consider that sale in forming your opinion as to the fair market value of the

(Testimony of John Alden Grimes.)

oil royalty interests of the Dominguez Estate Company?

Mr. Mackay: I object to that as speculative.

The Court: Overruled.

A. No, I did not consider that sale directly, because as Mr. Pemberton testified, the sale was made in order to pay estate taxes, and they had a choice of selling something and they chose to sell the oil royalties, and I considered there was some element of a forced sale in that transaction.

By Mr. Melville:

Q. Mr. Grimes, which is worth more, a lessor's interest in oil in the ground or the lessee's interest?

A. In my opinion, the lessor's interest is worth more than the lessee's interest in any property. The lessor has the first claim upon the income from the property. In an oil property, to be specific, the lessee pays all the cost of drilling the wells and bring the oil to the surface. [716] When he gets it to the surface he delivers a certain percentage of the total production, in the customary lease, to the lessor, without cost to the lessor. The lessee takes all of the risks. Now, if you compare the lessor and lessee interest in an oil property to a corporation, the lessor's interest, in my opinion, corresponds to the first mortgage bond of a corporation and the lessee's interests corresponds to the common stock.

Q. Mr. Grimes, are you familiar from your studies with the general market conditions as re-

(Testimony of John Alden Grimes.)

vealed by Dow Jones Averages and other analyses of the securities market in 1924?

A. Well, I know during 1924 we were having a severe—just emerging from a severe depression, and I know that at times during that depression that securities of very important companies were selling for substantially the book value of the net current assets, which would include bonds, preferred stocks and majority common stocks, in most cases. That is, if you could have bought all the securities of the company at the quoted market price, you could have bought those securities substantially for the book value of the net current assets of a number of large companies. The United States Steel Corporation at the bottom of the depression was one such company.

Q. Mr. Grimes, will you state, if you know, what the general market conditions were in 1938? [717]

A. I know there was a very precipitous decline in stock market prices during some part of 1938, as shown by the Dow Jones Averages. I believe it was the most precipitous decline in the stock market not excepting the 1929 crash.

Mr. Melville: I ask that this be marked for identification, your Honor.

The Court: Describe briefly for the record, please, what it is you are having the Clerk mark for identification.

Mr. Melville: It is tabulations on various sheets which represent Mr. Grimes' work done in support of his testimony and an explanation thereof.

(Testimony of John Alden Grimes.)

I will have him further identify it after it has been marked, if your Honor please.

The Court: Off the record.

(Discussion off the record.)

The Court: On the record then. The document which has been handed to the Clerk is now being marked for identification as Respondent's Exhibit HH and has now been handed to counsel for the Petitioner.

(The document referred to was marked as Respondent's Exhibit HH, for identification.)

Mr. Melville: I gave him a copy yesterday, your Honor, when Mr. Grimes started his testimony.

The Court: Very well. There being no objection, the document may be received. [718]

Mr. Mackay: If your Honor please, I would like to make this observation, that I understand this is not being offered in evidence as evidence of the value, but merely explaining the method, if my understanding be correct.

Mr. Melville: I will have the witness identify the document and explain what it is.

Mr. Mackay: I would like to be sure that the Court struck that out then.

The Court: Well, I will set aside my observation that the document was received in evidence. Now, you have some query you wish to make, Mr. Mackay?

Mr. Mackay: Yes. I said that I had no par-

(Testimony of John Alden Grimes.)

ticular objection to it if it is merely going in there to show computations, but if it is in evidence of value, I do object to it as incompetent, irrelevant and immaterial.

The Court: What do you say?

By Mr. Melville:

Q. Mr. Grimes, what does the document purport to be?

A. This is the detailed information obtained from Poor's and Moody's manuals and various sources of stock quotations which I believe are all mentioned on the sheets, for the 23 oil companies for which I was able to get published information. It classifies those companies into four groups, which I have already explained, and shows the average capitalization rates for each group, and it shows the detailed [719] sheet, each company in this group, with earnings, published earnings, published dividend figures and computations which I used in arriving at the capitalization rate of 9.66.

The Court: If I understand, Mr. Mackay correctly, he has only asked this—the witness has testified that he used certain figures, and Mr. Mackay is suggesting that we receive the exhibit itself not as proof of the facts occurring in the exhibit, but merely as data which the witness assembled for the purpose of making his computation, and I understand that is all you are offering it for, is that correct?

Mr. Melville: That is right, your Honor, not as evidence of value, but as supporting data back of Mr. Grimes' method of appraisal.

(Testimony of John Alden Grimes.)

The Court: Does that answer your question, Mr. Mackay?

Mr. Mackay: Well, not quite, your Honor. I must confess that with all the work I have had I didn't go over this a great deal. May I ask the witness one of two questions?

Mr. Melville: Certainly.

The Court: You may.

Mr. Mackay: Are these companies you have referred to, are their stocks all on the New York Exchange or Los Angeles Stock Exchange?

A. No, sir, the only company on the New York Stock [720] Exchange is the Texas Pacific Land Trust. There are several on the New York Curb Exchange, and there are one or two on Los Angeles.

Mr. Mackay: Just a moment now. How about these? Let's start with the first oil company lease in California, Merchants Petroleum Company, is that on the Los Angeles Exchange? Is it listed?

The Witness: That is my information.

Mr. Mackay: Do you know whether it is listed?

The Witness: It is traded on the Exchange. I wouldn't say whether it is listed on unlisted stock.

Mr. Mackay: You don't know if it is listed, do you?

The Witness: No.

Mr. Mackay: What about the M.J.M. & M. Consolidated?

The Witness: San Francisco Exchange. I wouldn't say whether it is listed or unlisted.

Mr. Mackay: What about the Mt. Diablo Oil,

(Testimony of John Alden Grimes.)

Mining & Development Company? Los Angeles?

The Witness: Los Angeles traded.

Mr. Mackay: You don't know whether it is listed?

The Witness: No.

Mr. Mackay: San Gabriel River Improvement Company?

The Witness: Over-the-counter.

Mr. Mackay: No listing? [721]

The Witness: It had been listed until August 1st, 1940, and then was withdrawn from listing with permission of the S.E.C.

Mr. Mackay: I am asking about that and you don't know. How about the United States Petroleum Company? Is that listed?

The Witness: Traded on the San Francisco Exchange.

Mr. Mackay: But not listed?

The Witness: I don't know whether it is listed or not.

Mr. Mackay: Well, if your Honor please, if it is just put in there as merely explanatory of his testimony, then I have no objection.

The Court: Very well. It will be received as Respondent's Exhibit HH.

(The document referred to, heretofore marked as Respondent's Exhibit HH, for identification, was received in evidence as Respondent's Exhibit HH.)

Mr. Melville: You may cross examine.

(Testimony of John Alden Grimes.)

Cross Examination

By Mr. Mackay:

Q. Mr. Grimes, I understood you to say that you are at the present time connected with the Government of the United States?

A. I am an employee of the Bureau of Internal Revenue. [722]

Q. And you are, at the present time, are you not, assigned to the general counsel's office?

A. Chief counsel's office.

Q. I mean chief counsel's office, if you want to correct me. A. Yes.

Q. How long have you been assigned to that position?

A. My recollection is since about March 1st, 1928.

Q. And you were assigned there for the purpose of sustaining values that the Commissioner had determined in issues pending before The Tax Court?

A. No, indeed.

Q. You work with trial lawyers in trying to sustain their values, don't you?

A. No, I work to try to find the right values, and possibly four out of five of the cases I consider are settled out of court without any trial.

Q. I know, but you are assigned to the trial attorneys who have the cases?

A. I work with the trial attorneys on any valuation cases that have been assigned to me for going to trial when I think that the government's position is right.

(Testimony of John Alden Grimes.)

Q. That is right, and you select the witnesses to help you on that, don't you?

A. I assist the attorney in selecting the witnesses. [723]

Q. Now, have you had any experience in—you are not a petroleum engineer, are you?

A. I wouldn't claim to be. I have had very slight experience with oil properties.

Q. Most of your work has been confined to mining?

A. Well, before I went in the government service it was principally mining, and some very slight oil experience.

Q. But you don't hold yourself out as a petroleum engineer?

A. No, I wouldn't think of doing so.

Q. Now, you keep a lot of statistics, don't you, Mr. Grimes?

A. Will you repeat that question?

Q. You maintain a lot of statistics, don't you, for the purpose of trying to check the values claimed by the taxpayers?

A. Well, I think I can answer that yes. I probably have individual folders on 1500 companies in the various lines of industry, that most of them have the summary and the entire published corporate history of that company, as to earnings, dividends, balance sheets, et cetera.

Q. And it is from there, those statistics, that you

(Testimony of John Alden Grimes.)

generally form your opinion as to value, isn't it, Mr. Grimes? A. No, indeed. [724]

Q. You don't use them in doing that?

A. Oh, I use them in doing it, but in forming an opinion of value, I follow a very definite procedure. I try to find the companies which are as comparable as possible with the one being valued. Now, in any industry you can find at any time almost a two for one difference in rates of capitalization. I try to pick the most comparable companies out of that industry in one manner or another. I consider size, I consider rate of growth, growth of earnings, I consider many things, and I narrow the comparison down to what I consider to be the most comparable companies in that industry. and then I try to form an opinion as to whether the company to be valued is better or worse than the comparatives I have, all of which is a matter of judgment based upon statistics, but I do use statistics, but I also try to use judgment.

Q. The whole success of your valuation depends upon your ability to select the comparatives, is that right?

A. Yes, for the sole purpose of ascertaining as nearly as I can what is the market for comparable property.

Q. And, of course, those statistics cover the whole United States, isn't that right, in a general way, I mean? A. Oh, yes, generally.

Q. So that when you are called upon to make a

(Testimony of John Alden Grimes.)

valuation you do not go up to the oil field and make an investigation, [725] do you?

A. No, it would be useless for me to go to the oil field to make an examination. What can you find out at the oil field is entirely a matter of record. No one has ever been underground in an oil field. They just have to take the records that are available.

Q. Maybe with the atom bomb we can go underground. A. Maybe.

Q. Now, I think yesterday, Mr. Grimes, you stated that you had made some computations which showed that based upon Mr. Paine's report or his testimony, that there would be a return of 18 per cent compounded annually, did I understand you to say correctly? A. That is right.

Q. What figure did you use to determine that 18 per cent?

A. I don't understand your question, I am afraid.

Q. How did you arrive at that 18 per cent?

A. I took the stipulated probable royalties——

Q. In barrels? A. No, no, in dollars.

Q. Okay.

A. I can't get compound interest on barrels of oil.

Q. I agree with you.

A. From that figure I deducted probable income taxes. [726] Those taxes were determined in accordance with the rates existing in 1941. I think the

(Testimony of John Alden Grimes.)

explanation of that is down here at the bottom of this.

Q. Can you tell without reading it?

A. Well, I can tell in a general way. The California Act had some provisions in it with respect to depletion and which the Federal tax laws had at that time. That was the 1939 Act. California charged four per cent tax on net income after depletion: I took depletion to an owner at 27½ per cent. Now, I could have used depletion to a buyer of the property, taking cost depletion, which would have given me a higher amount of depletion and less tax. I chose the lower of the two figures, deducting those estimated taxes—I didn't finish the federal tax on it. I used 22.1 income tax plus 20 per cent of that tax added for defense tax. That as of June 5, 1941 I should have regarded as a temporary measure, but I took it all the way through the life of the properties. Now, deducting the taxes from the stipulated probable royalties, gives a probable net royalty income for each year. From that net royalty income I deducted 18 per cent in 1941 for a seven month period of time, 18 per cent annual interest for that period of time on the value which Mr. Wentz testified to as of June 5, 1941. I took the full month of June, because the royalties for June would not be received until the end of the month, would not have begun in [727] the first five days, during those five days. That deduction of that amount of interest from Mr. Wentz's values left a certain amount available for capital retirement, so

(Testimony of John Alden Grimes.)

I reduced Mr. Wentz' original figure of \$2,701,361.00 by the amount of income available for capital retirement in 1941. I proceeded year by year on the same basis, taking 18 per cent on the remaining capital, that is, the capital at the beginning of the year. I first charged against income for each year, completing the balance of reduction of capital—I continued that on to the 1965 figures, in order to make that complete retirement of 18 per cent. I did that because we had \$296,000.00 of net royalty income after taxes, according to my computation, that had been received at the rate of \$55,000.00 in 1965, at the rate of \$61,000.00 in 1964, declining at the rate of about six thousand a year. I continued that decline for the next four years from 1966 to 1969, in order to retire the full amount of capital. The value of such income at 18 per cent that long after 1941 is very, very low. For 1968, for example, a dollar of income would be worth less than a cent.

Q. Now, Mr. Grimes, you spoke about the 18 per cent. Do you mean that it is 18 per cent of the unamortized capital? A. Yes.

Q. And how long, under your computation there, would it take the purchaser, based upon your computation, to recover [728] his capital and put it in his pocket so that Uncle Sam would not have hold of it?

A. Strictly according to this computation?

Q. Yes.

A. It requires the whole life of the property.

Q. I see. That is based upon the assumption

(Testimony of John Alden Grimes.)

that an investor would not get back his capital until 1965?

A. Well, in this computation there were a couple of thousand dollars that were not retired at the end of 1965, and it would take about four years more to retire those.

Q. I see. Now, Mr. Grimes, you say you used, I think your figures show a 19 per cent income tax rate?

A. No. I deducted 19.82 per cent of the gross royalties before depletion. That represents a much higher income tax rate after depletion.

Q. Well, what was your income tax rate? Did you say 22 per cent?

A. Yes, I used 22.1 per cent income tax and I used 10 per cent of that, which would be 2.21 per cent additional, of the taxable income, for defense taxes, and four per cent California corporation tax.

Q. That was the 1940 rate, was it, Mr. Grimes?

A. Yes.

Q. I understood you to say that in determining the fair market value of the probable future income, you did also [729] give consideration to the probable future taxes?

A. Are we on Mr. Wents' computation or on something else?

Q. No, I am just asking you now.

A. In this computation or in some other?

Q. No, in the method your have used.

A. With Mr. Wents', yes, I took off taxes.

Q. Now, Mr. Grimes, you were familiar with

(Testimony of John Alden Grimes.)

stock market conditions, weren't you, in 1941 to June 5, 1941?

A. Well, in a general way. I can't claim familiarity.

Q. No, you are not a broker and you don't have to keep track of all those cases, but you do have an opinion as to them, don't you?

A. Yes.

Q. You keep pretty well up on the trend of taxes, don't you, as statistician and expert for the government?

A. No, I can't say I do. My work is usually about five years behind the current taxes when it gets into court.

Q. I know that. I will withdraw that. What would happen to this computation, Mr. Grimes, that you have here, if, instead of using a 22 per cent less ten per cent more for defense tax, you used the actual rates in 1933, which I believe would amount to something like 33 per cent. I mean 1941.

A. 1941? [730]

Q. Yes. A. Well, I am not——

Q. You are not prepared to say?

A. ——prepared to say what it would be, but the computation would be modified.

Q. Very substantially, wouldn't it?

A. No, I wouldn't say substantially. The computation would be modified by the amount of the difference in taxes, and almost in direct proportion to the—well, I will go further than that. It would be modified in direct proportion to the net royalty

(Testimony of John Alden Grimes.)

income which you would have after the deduction of taxes.

Q. As a matter of fact, if it were demonstrated that by using the 1941 rates instead of having 18 per cent on your unamortized capital that you wound up with 10 per cent, would that change your opinion?

A. Well, I am not aware that the rates of the taxes were changed by June 5, 1941.

Q. I asked the question, would that change your opinion?

Mr. Melville: At this time, your Honor, I wish to ask counsel if it is in the record that this is Mr. Grimes' opinion or is this Mr. Wents' opinion?

The Court: Well, I presume the question is intelligible to the witness. Do you understand the question, Mr. [731] Grimes?

The Witness: I think I do. Mr. Mackay is asking me about 1941 taxes rates. I don't believe there was any change in the 1940 tax rates before June 5, 1941. If any change came about at a subsequent time, I would not apply the subsequent time to a valuation at June 5.

The Court: His question, as I understood it, Mr. Grimes, was, if you, instead of taking the percentage of 19.82 which you arrived at as shown in the Footnote B of this document which has been received as Respondent's Exhibit GG, if you would not obtain a substantially different answer if, instead of taking that factor, you had taken a factor equivalent to the tax rate which gave no consideration to the

(Testimony of John Alden Grimes.)

depletion, you would have gotten a larger return. Is that the substance of your question, Mr. Mackay?

Mr. Mackay: Except with respect to depletion. I merely meant to say this, if by using the same figures you used now when you took the 1940 rate, Mr. Grimes? A. Yes.

Q. Now, if by applying 1941 rates in the same method you have applied them here, it would show that the interest on the unamortized capital would be not 18 per cent, but 10 per cent, would that change your opinion as to the fair market value of the royalty?

A. Well, I still don't understand that question, [732] because in this computation I am not expressing any opinion about the fair market value of those royalties. This is Mr. Wentz' opinion. I am simply stating with such a value as he testified to with such taxes, there would be an 18 per cent return. Now, if the tax rates different from Wentz' were used, there would be some other rate of return. If they were higher than the ones I used, it would be a lower rate of return. If the taxes were lower than the ones I used, you would get a higher rate of return.

Q. That is right. It is a fact, Mr. Grimes, that the higher the taxes, particularly the higher the taxes on future income, the less the value would be, isn't that a fact?

A. Why, yes. I think that is self-evident.

Q. Now, when you came to an opinion as to

(Testimony of John Alden Grimes.)

the fair market value of a royalty, what tax rate did you use?

A. I used the actual taxes paid by the company. I was basing my comparisons upon 1940 income, therefore, that was the last published income which was available for comparative purposes of the companies whose stocks are listed or sold, and I compared the income of the Dominguez for the same period in making the comparison. Now, the price figures of the stocks for 1941 in themselves would reflect any tax changes before 1940 and 1941, in the stock prices.

Q. Do I understand then, Mr. Grimes, that in arriving at your opinion as to the fair market value of the oil [733] royalties, that you did not take into consideration the 1941 tax rates?

A. You mean of the Dominguez Estate Company's royalties?

Q. Yes.

A. No, I used the actual taxes the company paid. I used the actual instead of a merely theoretical computation.

The Court: Why do you show the actual?

The Witness: There was a certain amount of overhead expense——

The Court: I am asking you where do you show the actual taxes paid in this exhibit? Exhibit GG?

The Witness: I thought we had proceeded beyond that.

The Court: Have you? Well, maybe I was wrong.

(Testimony of John Alden Grimes.)

The Witness: No, this has nothing to do with the computation.

The Court: I didn't understand the reference to using actual taxes.

Mr. Mackay: No, I think that is a pertinent suggestion. I wish the witness would so answer it.

The Witness: In explanation of my valuation of the Dominguez Estate Company royalties yesterday, there were certain unallocated general expenses of the company which must be allocated, insofar as income was available from the assets for the values which had been stipulated. I allocated [734] those expenses to obtain a valid valuation which could be supported. Now, they represent about thirty-five thousand, if my recollection is correct, which the income from all the other assets of the company would not cover, and I allocated the entire remainder of that overhead expense to oil royalties, although I consider that was too high an amount of overhead expense to be allocated to the oil royalties, on account of leaving no profit and no loss from the assets for which values were separated, and attributed all the income tax paid by the company in 1940 to the oil royalties, and I deducted the full income, franchise and capital stock taxes paid out of only the oil royalties in making my valuation.

By Mr. Mackay:

Q. Now, Mr. Grimes, our problem here, isn't it to value future income, probable income, which

(Testimony of John Alden Grimes.)

begins on June 5, 1941 and extends to 1965? That is right, isn't it?

A. For the oil royalties?

Q. Yes. A. Yes.

Q. Now, in order to arrive at a value of that, we must necessarily take into consideration the amount of money that is going to finally come back into the investor's hands, the tax part and everything else, isn't that so? In my opinion it is the tax or any other income to the investor which determines the value. [735]

A. I don't think any investor would pay anything for the right to pay future taxes.

Q. Did you write a book?

A. Yes, I did.

Q. I think it is a good book, Mr. Grimes.

A. Thank you.

Q. On Page 99 I want to call your attention to just one item here: "The imposition of an income tax serves not only to reduce the amount of future income which the investor retains from the yield of the income producing property, but also to reduce the net earnings of sinking funds set aside to cover the return of the initial investments." You are still of that same opinion, aren't you?

A. Yes.

Q. And I will read you also another one here, where you said that: "But when depreciation or other deductions in the nature of a capital return operate to reduce the income subject to tax, and the price which an investor is willing to pay for a prop-

(Testimony of John Alden Grimes.)

erty is considered as determined on the choice of a future net yield after the payment of the tax on income and proper provision for the return of capital, the problem is more complex, as the value sought depends upon the amount of future tax." You still maintain that same view as expressed in that? A. Yes, I do. [736]

Q. Yes. All right. Then why, in valuing these royalties, did you not take into consideration the knowledge that there would be as a charge against this future income very substantially increased taxes?

A. My method of valuation did not require any theoretical consideration of what taxes would be. The companies wanted to make comparisons of the paid income tax in 1940, as paid by the Dominguez Estate Company.

Q. Yes.

A. Now, I compared market prices for those companies at June 5, 1941, arriving at my opinion of the value of the Dominguez Estate Company. Now, any change in the prospects for future taxation would be reflected in those market prices for the stocks of comparable companies, based upon what taxes they had paid in 1940.

Q. Now, you are familiar with the fact that before May of 1941 hearings had been held before the Ways and Means Committee for the purpose of greatly increasing the tax return?

A. Well, I am not familiar with that, but I assume that tax hearings started before that date.

(Testimony of John Alden Grimes.)

Q. I would like to call your attention to the federal income tax service. This is Prentice-Hall—you are familiar with Prentice-Hall, aren't you?

A. Yes, they published my book. [737]

Q. Here it speaks, referring to July of 1941: "During the first days of the Ways and Means Committee hearings, the primary subject is the proposals for new taxes. From the beginning the outstanding argument is on the question of how much taxes will be increased on individual incomes of less than \$2,000.00. They are planning to double and even triple those taxes, in many instances. The only certainty at the present is that practically all existing taxes will be greatly increased and that many new ones will be imposed, but the exact rates are far from being settled."

Now, I think you referred also to Moody. I think that is a reputable stock reporting service, isn't it?

A. Yes, very reputable.

Q. On May 5, 1941—I am reading from volume 33, number 18, "Sagging prices without any heavy liquidation were seen in last week's stock market. Many stocks touched new lows. No startling news accompanied this market reaction, which seems to be due partly to war conditions involving visions of higher taxes. It has been almost universally expected that the normal taxes of corporations would be increased from 24 per cent to 30 per cent; in fact, many corporations included the rate of 30 per cent in their reports for the first quarter. It was proposed that this increase could be accom-

(Testimony of John Alden Grimes.)

plished by imposing a surtax of six per cent on top of the normal tax of 24 per cent.” [738]

I would like to call your attention also to the Moody's of May 12, 1941: “We see no satisfactory signs of the old prices continuing, or going up in consistent fashion. The background still remains one of uncertainty about America's position in the war or the extent peace time production will have to give way to armament production or ideas of taxation. The atmosphere needs some clarification before stock markets can turn around even temporarily.”

I would also like to call your attention to one more——

Mr. Melville: Let me ask you a question, Mr. Mackay: Suppose the editors wrote those things? So far as I know, he has used the facts and figures that we agreed to go in without objection.

Mr. Mackay: Well, these are the reports you said I could refer to in your stipulation. Do you have any objection to them now?

Mr. Melville: Yes, I think it is a simple editorial that tried to analyze what is going to happen, and what someone said in these editorials, isn't anything but hearsay. I think this matter ought to be stricken out, your Honor.

Mr. Mackay: Well, if your Honor please, here is a man who is holding himself out as an expert and supposed to know—— [739]

Mr. Melville: He isn't responsible for what these people say.

(Testimony of John Alden Grimes.)

Mr. Mackay: He isn't responsible for what they say, but he ought to know what they say, if he has plans to talk as an expert. He, himself, referred to that in his direct examination, and I might state, too, your Honor, that at counsel's request I gladly put in the stipulation that witness could be referred to these various Moody's and Poor's and what not. Now, just because it hurts counsel a little, he is trying to object to the understanding.

Mr. Melville: No, your Honor.

The Court: Well, I think that the procedure has developed to this extent, that if you have some interrogation that you are making of the witness and calling his attention to some editorial or something, that is one thing, but standing up and reading into the record a bunch of editorials without tying it in with anything, without making it part of a question, just rather encumbers the record, because if you are going to adopt that method of putting in that sort of statement, I am going to rule it won't go in for any purpose.

Mr. Mackay: I appreciate that, your Honor. I will state to the Court I have only one or two more of these that I want to call to his attention and then ask him——

Mr. Melville: Your Honor, I am going to object.

Mr. Mackay: I am going to ask if he is familiar [740] with them, and if he doesn't know that situation was that, in fact.

Mr. Melville: Even assuming that it be the situation, I fail to see the materiality, your Honor, of

(Testimony of John Alden Grimes.)

that, and move to strike out the editorials that have been read into the record.

The Court: We won't strike them, but—I am only speaking as the judge presiding at this trial. I don't particularly care to have you read me a lot of editorials, unless you are assuming to ask some question in reference to what you are putting in; I can't think of any other reason for that at all.

Mr. Mackay: If your Honor please, I will re-frame the question.

By Mr. Mackay:

Q. I will ask you, Mr. Grimes, whether you are familiar with the report of the Moody stock service dated June 2, 1941, which said, in effect, that earnings would be smaller, that net earnings after taxes might decline somewhat further? [741]

A. No, I don't think I need to be familiar with that. The stock market has to take into consideration all these services and comments by anyone, not only by Moody, but by everybody who is making them.

Q. Well, you wouldn't say that the stock market at the end of 1940 had taken into consideration the tax imposed in July, for instance, 1941?

A. No, I haven't said any such thing. I say the stock market of June 5, 1941 is the basis for my comparisons, and the stock market is very sensitive to those expected future changes.

Q. All right, how far do you think the stock

(Testimony of John Alden Grimes.)

market reflected at the end of 1940 when you were checking the data the excess profits tax of 95 per cent?

A. Well, your question is not correct. I am not taking my data on stock prices at the end of 1940. I assume an earnings for 1940. Now, those earnings are not going to change a bit. You determine the value by what the stock market is paying for them on the basis of the year's' earnings. Usually, I think the factor I used was 9.67. Now, if I had used some other time of the year when there was less anticipation of future taxes, it might have been $10\frac{1}{2}$ times or 11. If I had used the picture at some other time when there was much greater anticipation of future taxes or lower income for immediate future years, whether it was 1941 or any other time, [742] that might have been 8 times earnings. At June 5, 1941, the stock market was about 9.67 times the 1940 earnings.

Q. Now, Mr. Grimes, I am not disputing the fact that the 1940 earnings that you were using would show certain values. I am merely asking you in valuing the future income here, in valuing the oil royalties, I should say, why you didn't take into consideration the contemplated and proposed increased taxes?

A. I did take that into consideration in that 9.67. That is the value per dollar of earnings that I used. That was the stock market's discounting of what those future taxes meant.

Q. Now, I am trying to find out how far—you

(Testimony of John Alden Grimes.)

see, we are trying to put values on estimated probable production of barrels of oil up to 1965. Now, in your opinion, how far in advance did the 1940 earnings of those companies that you have used as a basis reflect the increased taxes which could have easily been foreseen at the basic date?

A. Well, that is going to be a very difficult question to answer, Mr. Mackay, because we would have to go into what changes could be expected in the other current figures, and we have stipulated current figures throughout. Now, if you expect a change in one factor, you have to expect changes in others.

Q. Didn't the stock market, Mr. Grimes, in 1941, June 5—it was pretty well down at that time, wasn't it? [743]

A. Well, all I know is it was going up between June 1st and June 5th. It had gone up some.

Q. What were the Dow-Jones averages on June 1st?

A. Now, I can't carry those figures in my head.

Q. What were the Dow-Jones averages on June 5th?

A. I can't carry those figures in my head.

Q. How did you know they were going up?

A. I know the stocks owned by the Dominguez Estate were value at \$8,000.00 less on June 1st than they were on June 5th.

Q. Of course, you are taking about the securities they held? A. Yes.

Q. That is how you arrived at that. I under-

(Testimony of John Alden Grimes.)

stood you to say it would be quite difficult to take into consideration the probable income tax, possible future income tax, is that right?

A. No, I think I have taken that into consideration. If you mean for any one individual to appraise what the future held in store. I think that is impossible. The appraisement I have used in the consensus of opinion as reflected in the stock market.

Q. Now, Mr. Grimes, is it any more difficult in your opinion as a supposed expert to try to tell the Court what the value of probable income to be derived from probable production [744] of oil 25 years hence than to forecast some estimation of what tax will be collected upon that income?

A. No, they are both predictions. We have agreed upon one of those, however, and it is much easier for me to do that than to make independent predictions or accept somebody else's independent prediction of some other factor.

Q. Now, Mr. Grimes, may I ask you, did you make an analytic appraisal to determine the present worth of those anticipated royalties?

A. I made quite a number of them.

Q. Well, I don't want them all. Did you make any recent one? What was your present worth figure?

A. Oh, I didn't value them that way. I valued them by various rates of interest from 4 to 10 per cent, as simply a computation, and I valued them both on the basis of the owner who was taking 27½, I believe, and I valued them on the basis of the

(Testimony of John Alden Grimes.)

average earning and interest and depletion, and by general figures that would be returned after taxes, at an arbitrary 25 per cent rate on taxable income.

Q. You mean to say that you just arbitrarily assumed that that income to be expected in the future would be subject to a 25 per cent rate only?

A. I just made those figures——

Q. Now, answer that question, please.

A. I just took a flat 25 per cent rate for the purpose [745] of making those computations.

Q. I see. Well, what was it, for an individual buyer or was it for a corporation?

A. I could not make any computations for an individual buyer. They had to be for a corporation. Individual buyers would have to many different tax rates to——

Q. Well, now, will you please refer to Exhibit K-1, I think, and also to the stipulation. Now, I want to call your attention at this time, Mr. Grimes, to joint Exhibit 11-K(2). A. Yes, sir.

Q. I think that that shows that the total estimated probable income for 1941 would be \$412,652.00, right? A. Yes, sir.

Q. 27½ per cent of it would be a change for depletion, wouldn't it, of that? A. Yes.

Q. And how much would that leave which would be taxable? A. 72½ per cent of that.

Q. 72½ per cent of that amount, amounting to more than \$300,000.00, wouldn't it?

(Testimony of John Alden Grimes.)

A. You are talking now about the Dominguez Company?

Q. Yes.

A. Yes, because there would be a difference if a buyer bought these royalties and paid a higher price. [746]

Q. I understand, but I am speaking now that you are entitled to a 27½ per cent set-off because of depletion. A. Yes.

Q. All right. Now, therefore, that purchaser, if he used percentage depletion, would have an excess of \$300,000.00 taxable income; wouldn't he?

A. That is right.

Q. And the rate in 1940 would place him in what bracket? Isn't it about 60 per cent?

A. The Dominguez Company—

Q. I am talking about an individual.

A. Oh, I haven't any idea where it would bring an individual.

Q. Well, I will show you a table of rates for the year 1940. The rate for 1940 put him in a bracket there of over \$300,000.00, of 60.81, wouldn't it?

A. If he had no other income but this it would, but admit at that time there were people that were going out and purchasing companies that lost money in order to get lower tax brackets, so we have got to have all of your circumstances of a particular individual in order to see what the ownership of royalties of this kind would mean to him. You can't just assume that this was his whole income, so if

(Testimony of John Alden Grimes.)

you are going to get any individual to purchase it, they would not be able to purchase it as advantageously as a corporation. [747]

The Court: I suggest that questions be answered directly where it is possible to do so.

Mr. Mackay: Thank you, your Honor.

By Mr. Mackay:

Q. Now, after the 1940 tax the rates began at .44 per cent on the first \$2,000.00 and went to 60.81 at \$300,000.00, didn't it? A. Yes.

Q. Have you any idea what the tax on that \$300,000.00 of income would have been in 1941?

A. For a single individual?

Q. For a single individual A. No, sir.

Q. It would have been over \$183,000.00, wouldn't it, Mr. Witness? A. Not necessarily.

Q. Well, assuming that that is all the income the individual had, and that was his net income.

A. Yes, with those assumptions you are correct.

Q. Yes, all right. Now, if you apply the 1941 tax rates, the tax would have been greatly increased, wouldn't it? A. To this individual?

Q. Yes. A. I am sure that it would.

Q. Now, in your opinion could not the increase in income [748] taxes be as well foreseen as whether this oil would come out of the ground or not?

A. Well, I have tried to explain that.

Q. I will withdraw the question. Now, assuming that a corporation had purchased that?

A. Yes.

(Testimony of John Alden Grimes.)

Q. And what figure did you say was your figure for the oil royalties fair market value?

A. All your royalties, you mean?

Q. Yes. \$4,819,007.00.

Q. Well, call that approximately \$4,800,000.00. Now, let's assume that a corporation had bought that at that time, Mr. Grimes, and that it had received the income in 1941 for the value supported by the estimated probable income? A. Yes.

Q. What would have been its fair tax?

A. I don't know what his tax would have been. The rates undoubtedly were changed after June 5, 1941.

Q. Well, under the 1940 rates what would it have been?

A. I would say about 20 per cent.

Q. Well, what would have been the net income of the company, presuming that to be its net income?

A. I will have to give you approximate figures.

Q. That is all I want. [749]

A. A buyer that—

Q. No, we are not talking about a buyer. We are just talking about this hypothetical corporation that would give you that much money.

A. I am assuming that this company was a purchaser of the property for a value or substantially that, the nearest figure to that would be \$4,895,000.00 value to a buyer which would return him 7 per cent interest.

Q. No, I want to know the taxes, that is all I

(Testimony of John Alden Grimes.)

want to know. How much tax would that corporation have to pay?

A. Well, this is the answer for an individual.

Q. No, I don't——

A. An individual buyer. It is a slightly different basis. The average owner of the company would have 73.55 per cent of his income after his cost of depletion, so that he would have to pay taxes on the money he would be in receipt of, and the other 26½ per cent of his income would be allowed cost of depletion.

Q. That is right. Now, referring to this statement of tax paid by the corporation you have got 20½ per cent of its royalty paid as income tax.

A. About 23¼ per cent of the royalty income paid as taxes.

Q. How do you figure your cost of depletion, apply some barrelage basis? [750]

A. No, that is figured by getting the compound interest discount factor for total income. That is, what value each year's income had and apply a discount factor and then adjust for taxes.

Q. Your cost of depletion?

A. Why, surely. You are only paying with the income that you get back the tax from.

Q. Don't you develop the price for the average year's barrels and determine your depreciation from that?

A. Well, that is the same. I gave here a figure of depletion in terms of dollars of income, and we have a fixed price per barrel of oil, so that you get

(Testimony of John Alden Grimes.)

one rate on your dollar or you get one rate on your barrel, but they would be slightly different rates, depending on which one you are using.

Q. I know, but I am referring to the cost of depletion. Isn't it a fact the Government generally takes the value it sets or the cost, and divides barrels into that that to find the unit depletion?

A. Yes, that is the customary way.

Q. So they would apply that depletion rate to each barrel of oil that is pumped up?

A. That is right. And then, of course, the price changes. I don't use that method in my determination on the dollar income, because the price is going to change from day to day, and in all of these valuations we assume a uniform price throughout [751] the entire time of the life of the property, and when you do that you can figure a certain percentage of your dollar of income as depletion.

Q. What has the price of oil got to do with the cost of depletion?

A. It is just simply a method of estimating on how much of the total expected future income is coming to get taxes from. Now, you have got to get that tax expressed in terms of dollars. You can figure so many dollars of tax per barrel of oil and then multiply by the barrels of oil, but you have got to get it down to dollars.

Q. All right. Now, Mr. Grimes, let's assume that a corporation purchases for \$4,800,000.00 approximately so many barrels as estimated in the ground.

A. Yes.

(Testimony of John Alden Grimes.)

Q. Now, over how long a period would the Government allow that purchaser to spread his costs?

A. Over the remaining barrels of oil in the ground.

Q. That would be to 1965, wouldn't it?

A. In years, when I evaluated it it was to use up to and including 1965.

Q. It is your opinion, isn't it, in trying to determine the value of oil royalties, that you must take into consideration the estimated value of oil reserves and that the barreling stipulation has some bearing? [752]

A. I don't know whether I quite get your question.

Q. I don't either. I will withdraw it. By spreading that \$4,800,000.00 over the life or expected life of this field, what was your unit of depletion per barrel?

A. Well, I haven't figured that, but I will tell you how it could be figured per barrel. We have a certain total number of barrels less our equity, and you have got a total that is right in the exhibit here. I have that all figured, but you jump from one thing to another and I missed it.

Mr. Melville: Maybe this is what you are looking for.

The Witness: No, what I have in mind is right here. We have 7,992,871 total barrels of oil from all of these properties. We have \$9,029,979.00 of total expected royalty income. Now, it is simply necessary to find the ratio between those two.

(Testimony of John Alden Grimes.)

By Mr. Mackay:

Q. Well, let's compute it.

A. That is quite a job. I have the figures located up here, but didn't try to derive that accurately.

Q. Here is a slide rule Mr. Paine has.

A. Thank you, Mr. Paine. I think it is about 75 per cent. I can't——

Q. 75 per cent of what?

A. No, it has got to be more than that. If I divide— [753] there is approximately 8,000,000 barrels of oil and there is approximately \$9,000,000.00, which is approximately \$1.11 per barrel of oil.

Q. How much?

A. Practically \$1.11 average price per barrel of oil.

Q. And do you think that is reasonable, in the ground?

A. No, I am not taking in the ground. That is the price at the surface.

Q. Well, I thought you said that you took the total barrelage estimated oil reserves, somewhere in excess of 7,000,000, around eight, and you divided that into \$9,000,000.00, is that right?

A. No, I was just dividing the barrels of oil in the dollars of income. Now, I thought we were talking about—I had been talking about a certain percentage of each dollar of income that was returnable tax-free through depletion on a cost basis. Now, if you do that in terms of barrels of oil——

(Testimony of John Alden Grimes.)

Q. Just a minute. Let me ask you another question. Will you please take your valuation figure of approximately four million some hundred thousand dollars and divide that by barrels so that we can determine what price you think the oil is worth in the ground?

Mr. Melville: If your Honor please——

The Witness: Well, approximately 8,000,000 barrels, so that would be in rough figures 60 cents a barrel. [754]

Mr. Melville: I believe there is an exhibit here which shows the price per barrel of oil which both parties are in accord upon in treating the total amount of oil reserves and the future probable income.

Mr. Mackay: Oh, no, let's read the stipulation.

The Court: Well, it is figured on a basis of about \$1.13. Didn't you mention it several times?

Mr. Mackay: Yes, that is the revenue.

The Witness: I was talking about revenue, too, until now. I must have misunderstood counsel's question.

By Mr. Mackay:

Q. Well, to make it perfectly clear now, you have said in your opinion the oil royalty is worth four million eight?

A. That is right, and approximately 8,000,000 barrels, so it would be worth approximately 60 cents per barrel in the ground.

(Testimony of John Alden Grimes.)

Q. 60 cents a barrel in the ground?

A. 60 cents per barrel.

Q. And that is as to the holder?

A. To the purchaser and to the buyer.

Q. That is right. You heard Mr. Pemberton testify, didn't you, to the price that he assigned to oil in the ground in the Grubb Estate?

A. Yes, I heard him testify. I have forgotten what the figure is. [755]

Q. I will withdraw that. You heard Mr. Pemberton testify that the price at which the royalty interest in the Grubb Estate sold for reflected a value per barrel of oil in the ground at 60 cents, didn't you?

A. I have forgotten what his testimony is, but if you say that is it, I will accept it.

Q. Let's assume that it is so, and assume the record shows that. You also heard him say that that was worth \$1.57 at the surface, didn't you?

A. I don't recollect any of those figures, but if you state they are true——

Q. Let's assume that it is true. Now, what in your opinion would be the fair market value per barrel in the ground of the Dominguez Estate Company royalty, whose oil was at that time worth \$1.13?

A. I would not use that basis of comparison, because the last Grubb sale was in 1938, under different market conditions. I just would not apply that to 1941.

Q. Didn't I understand you to say on direct

(Testimony of John Alden Grimes.)

examination that you had made a comparison of that?

A. Yes, I had made a comparison. This company studies 50 per cent of the oil production of the United States, something over 50 per cent. They get confidential figures from companies as well as the public figures, and they make the most accurate and complete study that anyone makes. [756]

Q. Mr. Grimes, the substance of all that——

A. Well, the cost to the lessee to develop and drill for oil in the ground in 1941 was around 48 cents, and the lessee had to pay lifting costs, also had to drill that the lessor doesn't have to pay for, but simply 25 per cent on the cost of discovering and drilling oil, which is not unreasonable.

Q. Will you answer the question? I object to that as not responsive.

Mr. Melville: He is trying to explain his answer. He has a right to.

The Court: Please don't let's talk all at once. The reporter can't get it. Mr. Mackay made the objection that the testimony was not responsive to his question. I thought that also, and I might have sustained the objection. The witness has wandered a little after that. However, of course, it is correct, as the Colonel states, that the witness should be permitted to explain his answer, and we certainly want to allow him some latitude. I think, however, that we will suspend at this time on the cross-examination of the witness, and Mr. Mackey may

take it up later. We will be off the record for a moment.

(Discussion off the record.)

The Court: Let the record show, Mr. Reporter, we are suspending at this time until 2:00 o'clock.

(Whereupon, at 12:30 p. m., a recess was taken until 2:00 p. m. on the same day.) [757]

Afternoon Session, 2:00 p. m.

JOHN ALDEN GRIMES

resumed his testimony as follows:

Cross-Examination (Resumed)

Mr. Mackay: Mr. Reporter, please read the last question.

The Court: I think I probably broke up your last question, Mr. Mackay, by my remark.

Mr. Mackay: I think that is quite all right. I don't mind. I can reframe it, I think.

By Mr. Mackay:

Q. Mr. Grimes, let's assume that the oil royalty in the Grubb Estate was sold on the basis of 60 cents a barrel for oil which yielded \$1.57 per barrel when produced; what would be the comparative price per barrel of the Dominguez Estate oil at \$1.13?

A. Just a ratio of those two as of 1938, but I am not accepting that. [758]

(Testimony of John Alden Grimes.)

Q. Just tell me what is the ratio?

A. Well, it is the ratio of the two prices.

Q. Well, figure it out and tell me what the price on the barrel would be.

A. May I have the figures, please? Will you repeat your figures?

Mr. Mackay: Please read them.

(Question read.)

A. If my computation is correct, \$1.13 is 72 per cent of \$1.57, and if I were making any such comparison as that I would have 72 per cent of 60 cents, or 43.2 cents.

Q. That is right, isn't it? So upon that basis that would be a comparative value for the oil, wouldn't it?

A. No, it would not because this was the Grubb Estate.

Q. I said upon that basis, if this basis was correct.

A. I think those figures are correct, but I do not admit the correctness of the basis.

Q. No, just assuming the basis is correct.

A. Assuming your basis of comparison is correct, I think it would figure 43.2.

Q. And that would be the comparative value of this oil in the Dominguez? A. No.

Q. I mean assuming that that basis is correct.

A. No, I am not going to assume 1938 prices as correct for 1941.

Q. No, but just assume, can't you assume it just now without hurting you?

(Testimony of John Alden Grimes.)

A. I am willing to assume that this would be a correct basis for Dominguez in 1938, but that is as far as I am willing to assume.

Q. You don't want to assume what I asked you to assume? A. No.

Q. Now, Mr. Grimes. I think you said that the Grubb Estate was forced to sell it royalty and for that reason the transaction could not be used as a comparative?

A. No, sir, I think you misunderstood me. I said that the Grubb Estate sold these royalties in order to pay inheritance taxes. Now, they could have sold either the royalties or something else that the Estate owned, and it was not forced sale of the royalties, but I said that it had some aspects of a forced sale, in my opinion.

Q. What aspects?

A. Simply that they had to sell something to get money to pay taxes.

Q. Couldn't they have borrowed the money?

A. I imagine they could, at least in part.

Q. Don't you think they could have borrowed the whole [760] amount?

A. Well, I will assume that they could.

Q. Well, then, if they could have borrowed the money to pay that tax, then it has no aspect of being a forced sale, is that a fact?

A. No, I couldn't say that. If they borrowed the money they pledged the whole estate as security for the loan.

(Testimony of John Alden Grimes.)

Q. You mean to say that they would have to pledge the whole estate?

A. They would have to pledge something that was ample security.

Q. I know, but do you know the size of the estate? A. No, I do not.

Q. Don't you know as a matter of fact that the oil property was producing about \$4,000.00 a day?

A. No, I am not familiar with the details.

Q. You are not familiar with the details. Then you don't mean, do you, to give the Court the impression that there was any aspect of this sale that was in any way to be considered a forced sale?

A. I said I didn't consider it because I thought that it had some of the aspects of a forced sale. I am not testifying as to whether it was a forced sale or not.

Q. Will you please tell the Court in what respect it had some aspects of a forced sale? [761]

A. I think I have explained that.

Q. Can't you do it now?

A. Yes, I can repeat my explanation.

Q. All right.

A. I said that the estate had heavy federal taxes to pay and I imagine state inheritance taxes too, and that they had to sell something or—I will accept your amendment—or borrow money in order to pay these taxes. They chose to sell the oil royalties rather than to borrow money or sell something else that the estate owned, and in my opinion that had some of the aspects of a forced sale, so I did

(Testimony of John Alden Grimes.)

not consider the matter as a proper basis for comparison. Now, if anybody else considers that it is not a forced sale, I have no objection at all to their using it or considering it to be a free sale.

Q. Well, Mr. Grimes, you as a government engineer would not want to convey to the Court the idea that there was a forced sale or that it had any aspects of a forced sale unless you had made a sufficient investigation to determine the truth of it?

A. I am not testifying as to the fact that it was not a forced sale or a free sale, but I said I did not consider that sale in arriving at my opinion of the value of the royalties of the Dominguez Estate Company, because it was the only large sale of royalties which I was able to get track of for [762] some years back of 1941, and that considered personally that it had some of the aspects of a forced sale, and since I had that opinion I did not use it.

Q. I think you also stated in direct examination that the pumping of wells was not curtailed in the Los Angeles area, in the Dominguez area?

A. It is my understanding that curtailment applied principally or exclusively to flowing wells, that there was very little or no curtailment of pumping wells at any time in California.

Q. Now, would you change your opinion if you knew as a fact that the pumping wells were curtailed as well as the flowing wells? Will you answer me yes or no, please?

A. Yes, to the extent that the curtailment was identical.

(Testimony of John Alden Grimes.)

Mr. Mackay: Would you read me the question and answer, please?

(Question and answer read.)

By Mr. Mackay:

Q. Identical with what?

A. Identical percentages of curtailment with respect to both pumping and flowing wells, and I would like to change that answer, if I may. I would not change my opinion because I do not think that the price per barrel of daily production has any place in the valuation of a group of oil [763] wells as compared to another group in a different state of development, and I do not consider that it has any place when there is any curtailment of any kind; that that method applies perhaps fairly well to a single well over its flush production, that has a fairly well established rate of production, and it is just a version of the pay-out method, and I think a more inaccurate method than the one based on income.

Q. Just a minute, witness. I don't mind hearing you argue when we reach the argument in the case, and that is all right, probably. Now, what effect, in your opinion, would curtailment have upon your value?

A. If your price is based upon full production, say your well can produce a thousand barrels a day and you say that is worth \$1,000.00 a barrel of daily production, that would be worth a million dollars

(Testimony of John Alden Grimes.)

even. Now, if that well was curtailed to 500 barrels a day production and you still valued it at \$1,000.00 a barrel, we have only got \$500,000.00 value. You have just cut your value in half by that curtailment.

Q. That is right. Now, assume that you had curtailment here for say 10 years immediately after 1941; isn't it a fact that your recovery of the probable oil would be delayed considerable? Can you answer that yes or no?

A. No, I can't answer it that way. It depends upon [764] where the curtailment was greater or less than that in effect in working out the schedule of probable future production.

Q. Well, suppose it was greater, and you deferred the getting of your oil out for another 10 years, would that effect your value?

A. Not as of the date June 5, 1941, if it was a subsequent event. If it was definitely foreseeable June 5, 1941, and I had not taken it into consideration, it certainly would affect my opinion.

Mr. Melville: Mr. Mackay, do you want him to assume something, assume a different set of facts than any stated in the stipulation? Will you clearly present the facts you want him to assume?

Mr. Mackay: If your Honor please, this is cross-examination.

By Mr. Mackay:

Q. Now, Mr. Grimes, did I understand you to say that it was your opinion that the value per

(Testimony of John Alden Grimes.)

share of the Dominguez is equivalent to the fair market value of the total assets divided by the total number of shares outstanding?

A. That is right.

Q. That is your opinion. What justification do you have for your statement that in a family corporation the shares are of very little importance?

A. A family corporation is much easier to liquidate [765] than one which has shares held by twenty or forty thousand stockholders. The stockholders are a whole lot closer to getting possession of the assets at any time it becomes for the benefit of the majority to do so.

Q. Why more so than in any other corporations, like, say, the Lehmann Corporation?

A. Well, that is very widely held by the public and the stockholders will have entirely different suggestions, different ideas, and not such friendly cooperation as you would have in a family; if it became to the advantage of a sufficient number of members of the family to liquidate the corporation, it could be done.

Q. Now, suppose that your willing buyer of the stock of Dominguez happened to be an outsider, one who is not in the family?

A. That is right.

Q. Would your opinion be the same?

A. As to his being able to get his liquidating value?

Q. Yes. A. No.

Q. And then if you had a willing buyer who is

(Testimony of John Alden Grimes.)

not a member of the family, you would not base that on the asset value, then, would you?

A. No, to an outsider who was in no manner connected with the family, I would not base it upon asset value. [766]

Q. Now, you go down through the corporations on the same basis, don't you, with no discount whatever? A. That is right.

Q. Don't they provide any discount?

A. You mean on the asset value or from the value of the assets?

Q. I should have made that clearer. I am sorry. You take in the asset values of Dominguez and you divide them by the number of shares. Now, getting down into the Francis Land Company, as I understand you to say, you appraised the Francis Land Company stock, I think, at a hundred and ten per cent of the appraisal you put upon the Dominguez Company, didn't you?

A. That is correct.

Q. And now, doesn't the Francis Land Company have to pay taxes at least on 15 per cent?

A. Yes, that amounted to about seven thousand average yearly taxes and overhead expenses, a total net expense of running the corporation, about seven thousand a year from 1936 to June 5, 1941, inclusive. It was somewhat lower in 1940. It was about \$4,000.00.

Q. Now, suppose that you had 10 corporations owning stock in each other instead of three, as we have here, would you still be of the opinion that

(Testimony of John Alden Grimes.)

the stock of the tenth would be worth the value of the assets of the first? [767]

A. If they were just a group of family corporations and formed to show or to enable the family to have an easy way of passing on fractional interests in property, I should say yes. Now, corporate ownership of real estate, oil properties, and so forth has considerable advantages to a family group, because if the administration is handled by one person, a corporation, instead of having to get the consent of a great number of individuals to any course of action.

Q. Now, Mr. Grimes, would your testimony with respect to the Francis Land Company stock and the Carson Estate Company stock be the same you had this morning in respect to Dominguez, so far as an outsider buying that stock?

A. Yes. I don't think any outsider would buy into a family holding company unless he could get the stock for a bargain price. Now, that is quite exceptional. I don't know that there are some sharpshooters, let's call them, that do buy into situations like this simply to make such a nuisance of themselves that they can sell it for more than their stock is worth, but I am eliminating that classifying.

Q. But you would not have an informed willing buyer willing to pay that and a seller who is equally informed getting paid for it. That wouldn't happen in this case, would it, if you eliminated it?

A. For anyone buying strictly for income taxes,

(Testimony of John Alden Grimes.)

I should judge that the stock outside of the families would sell [768] for a lower price than it would sell within the family, or be worth to family members.

Q. Now, Mr. Grimes, I would like again to call your attention to Page 2 of your book. This is your book, isn't it? A. Yes.

Q. I want to ask you a question about this, and whether or not you are of the same opinion now as you were when you wrote the book.

A. I think I am, yes.

Q. "The price at which income producing property passes from one owner to another is determined not only by its value, but by such intangible elements as comparative knowledge, buying ability and foresight of the buyer and seller. The asset value depends upon the ability of the valuator to reach his own conclusions based upon the elements determined by analysis of prospective transactions as well as completed transactions, and consideration of those important factors plays a part in an exhaustive valuation." I think you have answered the question that you are still of the same opinion?

A. Yes, I am.

Q. I will ask you, Mr. Grimes, where in your valuation here you gave effect to the need of the buyer or seller, or to the bargaining ability of either or both?

A. I am assuming that this would be a free transaction [769] on an open market, and knowing that these stocks were available to the public, I have to use the market for similar stocks as an

(Testimony of John Alden Grimes.)

indication of their value. If all of the stock of any of these companies should be listed upon a reputable stock exchange, I think it would still have the values to which I have testified, including \$558.78 for Carson, which I didn't have in direct testimony.

The Court: What is that?

The Witness: \$558.78.

Mr. Mackay: Just a moment. I think the answer is not responsive to the question, if your Honor please.

The Witness: I am sorry.

The Court: Well, it seems to be preliminary, and had you finished answering the question, Mr. Grimes?

The Witness: No, I had not.

Mr. Mackay: I don't want to stop you unless you are trying to argue the case.

The Witness: I tried to resolve all of these intangible elements by using the market for comparable stocks and minority stocks of comparable companies. In order to make a valuation at all, you must assume that these stocks are sold under comparable circumstances. The conclusion of my remarks was a mathematical or analytical appraisal which applies the discount methods and rate of receipt, and I didn't use that method in this valuation. I used the method of [770] comparing with the actual market.

Mr. Mackay: I see. That is all.

(Testimony of John Alden Grimes.)

Redirect Examination

By Mr. Melville:

Q. Mr. Grimes, in making your analytical appraisal, did you take into consideration whether or not the stockholders of these various stocks were willing to let it get outside of the family group?

A. No, I tried to figure a value that would obtain between a willing buyer and a willing seller if the stock were traded in upon a public exchange the same as other oil royalty stocks which I have used as a basis for comparison.

Q. Now, if the stockholders, members of the family groups, had a policy or practice to not permit the stock to get outside of the family group or if it did get out to buy it back, what effect would that have on the appraised value?

A. Well, that obviously would increase the price at which the stock could be sold.

Q. But you haven't added any factor to cover that possibility?

A. No, I have not.

Q. Assuming, Mr. Grimes, that the oil properties of the Dominguez Estate Company were for sale on June 5, 1941, and that among the prospective willing buyers there were corporations and there were individuals, individuals being [771] in various tax brackets, do you have any opinion as to who would be the highest bidder for the oil royalties?

A. I should think either a corporation or a group of individuals in relatively low income brackets, not those that had the highest tax brackets.

(Testimony of John Alden Grimes.)

Q. Mr. Grimes, following the same methods that you followed in valuing the oil properties of the Dominguez Estate Company, have you valued the oil royalties of the Carson Estate Company?

A. Yes, I did so before the value was stipulated. I have used the stipulated value of \$285,000.00 in my determination of the value of the Carson stock.

Q. Your testimony, then, in this case is based upon the stipulated value of \$285,000.00 for the oil royalties of the Carson Estate Company?

A. That is right.

Q. Now, prior to the stipulation of \$285,000.00, did you independently arrive at your opinion in the same manner and using the same methods as you used to value the oil properties of the Dominguez Estate Company, and arrive at an independent appraisal of the oil royalties of the Carson Estate Company?

A. Yes, I did.

Q. What was that opinion?

A. \$276,000.00, and I would like to explain that I [772] followed the same method, but I did not use 9.67 times earnings. I used 6 times earnings.

Q. Would you state why?

A. Because I considered the Carson royalties were considerably poorer in character, judging from future expectation, than the Dominguez. They are telescoped more into the early period and seemed to have a much more rapid decline toward the latter part of their productive life.

Q. Mr. Grimes, the various opinions that you

(Testimony of John Alden Grimes.)

have expressed during your testimony in this case, what were they based upon?

A. They are based upon my opinion of what these stocks might have been sold for if offered to the public and listed upon public stock exchanges. They are based strictly on what I consider the market price of the stocks would be, and I arrived at that opinion by means of averaging what stocks of other oil royalties were selling for, which I considered to be comparable.

Q. In making appraisals, Mr. Grimes, do you consider that the result is dogmatic?

A. No, I think it would take a fine appraisal to be right within 10 per cent plus or minus.

Q. In formulating your opinions, which you have expressed in this case, did you or did you not base those opinions on appraisals which you thought were correct within [773] the margin you have just stated?

A. Well I tried to figure it. My figures are strictly appraised figures, and if they are right within 10 per cent above or 10 per cent below those figures, I would consider they were very fine appraisals. I just don't think appraisals can be made more accurately than that.

Q. Have the figures that you have expressed in this case been based upon such appraisals?

A. Yes.

Mr. Melville: No more questions.

(Testimony of John Alden Grimes.)

Recross Examination

By Mr. Mackay:

Q. Mr. Grimes, I understood you to say that in computing the value of the Carson royalties, you used six times earnings, is that right?

A. That is right.

Q. Well now, what if you used that same figure, six times earnings, what would be your value for the Dominguez?

A. Well, I could figure that out, just the difference between six and 9.67. I didn't use any such figures.

Q. Well, that would cut it about in half, wouldn't it, Mr. Grimes, your value?

A. Oh, no, 60 some percent on the royalties.

Q. In other words, it would produce a much lower value, wouldn't it, to use the same earnings?

A. Oh, obviously, if you multiply the earnings by a lower figure you are going to get a lower value.

Q. Well, they are pretty much holding companies?

A. We were talking strictly about the oil royalties, not about holding companies.

Q. Yes, that is what I mean. So that if you applied the same basis of six times earnings to the Dominguez as you did to the Carson you would get a value very much lower than the value you have placed on it, wouldn't you?

A. Yes, but that would not be my opinion of the value of the Dominguez.

Mr. Mackay: I think that is all.

Redirect Examination

By Mr. Melville:

Q. Mr. Grimes, what affect, if any, did it have upon your viewpoint and your methods of appraisal, the fact that the parties to this case stipulated to \$285,000.00 for the value of the Carson Estate Oil royalties?

A. Well, of course, it was very pleasing to see that Mr. Paine and I had arrived at such close approximation of the value of the particular asset.

Mr. Melville: No more questions.

Mr. Mackay: No more questions.

The Court: Both sides are now both through with Mr. Grimes, so that so far as examination is concerned, he may be excused, is that right, gentlemen? [775]

Mr. Mackay: That is right, your Honor.

Mr. Melville: That is right, your Honor.

The Court: Very well.

Mr. Mackay: I would like to call Mr. Paine.

PAUL PAINE,

recalled as a witness for and on behalf of the Petitioners, having been previously duly sworn, was further examined and testified as follows:

Further Direct Examination

By Mr. Mackay:

Q. Mr. Paine, you were in Court yesterday and heard Mr. Phillips testify, did you not?

A. Yes, sir.

(Testimony of Paul Paine.)

Q. And you heard him refer to the report of the Dominguez Oil Fields that you made?

A. Yes, sir.

Q. Can you tell the Court for what purpose that was made? Yes, sir.

Q. Please.

A. That report was not a report estimating the market value of the Dominguez Oil Fields properties or its stock. I was engaged for the purpose of estimating the oil in the ground, the probable future profits that would be derived through its recovery, and that report accomplished that and [776] ended there. The finding of the report finally was expressed as an estimate of so many barrels of oil recoverable and the probable profit it would yield in the course of time. Then to this future estimated price was applied a discount and the present worth thereby ascertained. That present worth figure was about \$66.00 per share of stock, on the 400,000 outstanding shares of the company. At that point my part in that ceased, the bankers—the report was delivered to the bankers. They then conducted their negotiations. The present worth as I found it was \$66.00 a share. The bankers paid \$32.50.

Q. Did you set out a formula in your report?

A. No, I didn't. There was no formula.

Q. Now, you have heard some testimony with respect to the Grubb property. A. Yes.

Q. You are familiar with that, aren't you?

A. Yes, I am familiar with the property.

(Testimony of Paul Paine.)

Q. I think you testified on direct examination that you were consultant, engineering consultant for the Bank of America? A. Yes, sir.

Q. At about the time this sale was made, were you consulted about the properties?

A. I was. Yes, I was asked about the properties and about the situation there, because the bank was just considering [777] the question of a loan to the estate and I was asked what I thought of the merits of a loan to the estate. My reply was that I didn't know what the estate was worth, I had made no appraisal of it, of the whole assets, but undoubtedly they go up into a number of million dollars safely.

Q. In making a loan?

A. Oh, yes.

Q. What have you to state with respect to the testimony of Mr. Grimes that the sale had the aspect of a forced sale?

A. Well, if I am required to answer that I would say he is mistaken. I can understand very well how he could be mistaken. This estate had a tremendous amount of property.. Mrs. Grubb when she died had a lot of money, and it took all the money she had to pay the inheritance tax, and then this sale was brought about in connection with their undertaking to secure the balance of the funds necessary. The trade was a unique one in this respect, that it did not offer a certain percentage of royalty or a certain royalty interest to the highest bidder. They desired to know who would accept the smallest portion of that royalty in return for

(Testimony of Paul Paine.)

this amount of money which they were seeking.

Q. Now, Mr. Paine, can you tell the Court whether or not at this basic date, June 5, 1941, there was any curtailment on public wells?

A. A great many of the public wells in the Dominguez [778] field were greatly curtailed at that time.

Q. As well as the flowing wells?

A. Oh, yes.

Mr. Mackay: Take the witness.

Cross Examination

By Mr. Melville:

Q. Mr. Paine, are you a graduate engineer?

A. Yes, sir.

Q. What school?

A. From the Massachusetts Institute of Technology.

Q. What degree? A. Bachelor of Science.

Q. In engineering?

A. They don't give it for engineering. I graduated, however. Answering your question, graduated in the course of geology. They have courses in civil engineering, mechanical engineering, electrical engineering, and so on, about a thousand of them. One of those courses is geology. In that I took my degree.

Q. And received a Bachelor of Science degree.

A. Yes.

(Testimony of Paul Paine.)

Q. This Dominguez Oil Field property appraisal that you refer to, what year was that in?

A. I think it was 1938.

Q. Or was in 1934? [779]

A. No, July 21, 1938.

Q. Did you consider the situations involved in the Dominguez Oil Fields property appraisal that you made in 1938 controlled or strongly influenced the situation of the questions involved in this case, which related to 1941?

A. May I have that question, please.

(The question was read.)

A. That sounds like an awfully complex question to me. I shall try to answer it.

Q. If you don't understand it, I can rephrase it for you.

The Witness: I don't want to avoid this now, your Honor.

By Mr. Melville:

Q. Please tell the Court what went into your explanation of the Dominguez Oil Fields property appraisal in 1938, on your direct examination.

A. I was asked if I had heard Ralph Phillips yesterday relate about this appraisal, and about the formula which he had followed in estimating the value of this property in 1941 and to which he testified.

Q. Is that true——

A. Now, may I finish?

Q. Surely.

(Testimony of Paul Paine.)

A. And I was told about this report, and you asked me [780] now—state your question.

Q. I am wondering what the connection is between that report and our case.

The Court: May I ask counsel, you used the word controlling, what did you mean, controlling upon this witness or what?

Mr. Melville: No, no, influenced in any manner any opinions that this witness may have expressed.

The Court: Did you understand the question? I am sorry, I didn't.

The Witness: I am sorry. I did not.

Mr. Melville: I will start over again.

By Mr. Melville:

Q. Mr. Paine, do you think in forming an opinion as to the fair market value of the oil royalties of the Dominguez Estate Company as of June 5, 1941, that the report of appraisal that you made as to the Dominguez Oil Fields property in 1934 has any bearing?

Mr. Mackay: I object to that, your Honor, 1934; the record shows 1938.

Mr. Melville: All right, 1938. I will correct the question.

The Court: I would be inclined to think that if the question of something along that line is proper, it would have to be confined to whether or not this witness has taken such into consideration himself. Now, it will be our peculiar [781] province to deter-

(Testimony of Paul Paine.)

mine whether there is any connection between the two.

Mr. Melville: Well, maybe I am confused, your Honor, and your Honor quite unconsciously went along with me. The first thing we talked about on direct examination was this Dominguez Oil Field property appraisal in 1938, and I am frankly confused, I don't know the purpose for which it was taken up. I would like to have the record, or at least myself cleared up on that.

The Court: Well, Mr. Phillips made some reference to it during his testimony. Now, whether he thought that there was some formula in there and that he was applying—I think he stated in a general way that he had relied upon a formula or some method of calculation as contained in that report.

Mr. Melville: Was this witness then for the purpose of impeaching the testimony of Mr. Phillips?

The Court: Well, I would think that perhaps that is the primary purpose, although I can't say why counsel put the witness on or asks a certain question.

By Mr. Melville:

Q. Well, Mr. Paine, what opinion did you express in this case as to the fair market of the oil royalties of the Carson Estate Company.

A. I didn't testify on that. That oil property—or that stock, I think you asked me about.

(Testimony of Paul Paine.)

Mr. Mackay: He is talking about oil properties.

The Witness: \$283,000.00.

By Mr. Melville:

Q. And what opinion did Mr. Phillips express?

A. I don't remember.

Q. I think the record will show it was two hundred eighty-five thousand some odd hundred. What significance do you attach to the fact that Mr. Phillips came within a few hundred dollars—within two thousand dollars, pardon me, and within a few hundred dollars of the stipulated fair market value of those oil royalties.

A. I can't guess that for you. I would have to guess. It would be an opinion.

Q. That is what you are up here now expressing.

The Court: I doubt it. No, we have him here as an expert to tell us what he knows and what his opinion is.

The Witness: I can relate——

The Court: Wait a minute.

The Witness: I am sorry.

The Court: When you get him over into the realm of guessing, I don't want to hear from him.

By Mr. Melville:

Q. Mr. Paine, were you an employee of the Grubb Estate in 1938? [783] A. Never.

Q. Then what you have testified to with respect to that estate was entirely hearsay?

A. No, sir.

(Testimony of Paul Paine.)

Q. Where did you get it?

A. Well, I heard Mr. Pemberton testify yesterday with respect to the price the property was sold for and what the estimates of the oil reserves were, and the equivalent basis per barrel of oil in the ground, at the time that transaction was made, also at that time I knew of the sale coming up and knew that this problem confronted the estate. I was asked by the bank officers to give them an indication of what I thought this property might earn, and in addition Guy Witter and I, and Guy Winter is the Southern California partner of Dean Witter & Company, discussed and made tentative efforts to try to buy that royalty.

Q. Did you consider the sale of that Grubb Estate oil royalty in forming your opinion that you expressed as to the fair market value of the oil royalties of the Dominguez Estate Company in this case?

A. That is one of the transactions that I took into account in my estimate, yes, sir.

Q. How much weight did you attach to it?

A. I can't say it in that specific form. It was the largest transaction of a comparable nature that I know of in [784] Southern California within recent years.

Q. You heard Mr. Grimes' testimony?

A. Yes.

Q. You heard what he said about the weight that should be attached to the sale of the Grubb

(Testimony of Paul Paine.)

Estate in 1938, in making valuations in this case?

A. Yes.

Q. Do you agree with him?

A. No, I do not.

Q. Why?

A. Because that transaction was conducted and closed on such a basis that the value of the oil in the ground was purchased on the basis of approximately 38 per cent of the price oil was bringing at that time. Now, that is a significant figure here to me, because that is not related to the time. That is the ratio of oil in the ground to the price it brings, and if later on oil went up in value and in return, I would expect the value of the oil in the ground to be greater. Now, applying that same ratio to \$1.13 oil, one gets a comparable figure on a percentage basis, that is, properly comparable, irrespective of the time element, of 43 cents per barrel. I used 40 cents a barrel in my estimate.

Q. And where do you get the price for the oil that you used in this comparison of price of the Grubb Estate oil?

A. Phil Pemberton testified right here the other day [785] confirming what I had.

Q. Do you know whether that is the posted price or whether it is——

A. Oh, no, that is not the posted price.

Q. Well, do you know that it is not?

A. Yes, because this figure is the return of revenue from oil, gas, gasoline, butane, protane, and other by-products per barrel of oil, which is the

(Testimony of Paul Paine.)

common unit that we use in these computations. You know one question was put to me, that is, where I got the figure of \$1.57 originally.

Q. No, I didn't ask you that.

A. I am sorry. I think the record will speak for itself, where did I get the figure of revenue per barrel of oil.

Q. I was referring to where you picked up or determined the price per barrel of oil to the Grubb Estate in making your comparison.

A. The price per barrel of oil in the form of revenue.

Q. That is right.

A. Yes, that is what I say I have not answered fully for you. Phil Pemberton testified to \$1.57. At the time of this transaction I asked Don Bartl, the field engineer of the Shell Company, what that amounted to, and he told me.

Q. Was that a gross price including all products and everything? [786]

A. Well, yes, if I understand you correctly. That is the revenue, the revenue, not the price, the revenue from oil plus the revenue from gas plus the revenue from casing-head gasoline and all other products added up and divided by the number of barrels.

Q. The gross revenue without any deductions for anything.

A. Yes, yes. I mean no deductions from Mrs. Grubb's income tax or administration that she had to pay for or anything of that kind. That is the

(Testimony of Paul Paine.)

dollars she received from the Shell Company per barrel of oil produced. Now, there were deductions.

Q. I think that answers the question.

A. No, it doesn't. I am trying——

Mr. Mackay: Let him explain it.

The Witness: There were some deductions probably, according to the terms of her lease, because very often the leases provided that as to the costs of gasoline or other products there shall be some contribution on the part of the lessor toward the cost of recovery of these by-products. I don't know what those were, but that is deducted before the money is passed over to the lessor. And this is the amount of money which came to her, divided by the number of barrels, and if that is what you mean by gross, that is my answer. On the other hand, if by gross you mean the total amount of money, I am sorry that just as I indicate that I am——[787]

By Mr. Melville:

Q. Go on if you want to.

The Court: I suggest we may be getting away from rebuttal, and certainly from cross examination on testimony that was given in rebuttal. Maybe I will have to stop it. I don't know.

By Mr. Melville:

Q. Mr. Paine, I think you imagine my question, now. What effect, if any, does the matter of curtailment in the Dominguez Oil Field have on the stipulated facts in this case?

(Testimony of Paul Paine.)

The Court: I am afraid that is a rather broad question, and perhaps invading our province, Mr. Melville.

By Mr. Melville:

Q. When you studied the stipulation of fact in this case, Mr. Paine, did you consider that the agreed future production in royalty dollars took into consideration the probable curtailment in the Dominguez Oil Field?

Mr. Mackay: If your Honor please, I object to that as not proper redirect.

The Court: He may answer if he knows.

The Witness: Well, I was a little doubtful about it as I observed the figures, because they seemed to conform to the actual production.

Mr. Melville: Answer the question yes or no and then explain it. [788]

Mr. Mackay: May I interject here?

Mr. Melville: I think he is capable of answering that question.

The Witness: Let me make sure of the question.

(The question was read.)

The Witness: Oh, yes, we assumed that in this stipulation you had taken into account every element. I accepted the stipulation 100 per cent.

By Mr. Melville:

Q. So that any of your testimony here on direct examination as to curtailment is not intended to change your opinion or anybody else's opinion?

(Testimony of Paul Paine.)

A. No, it is intended to impeach Mr. Grimes, as far as I am concerned. He didn't know the fact.

Q. Well, do you consider that Mr. Grimes had to go beyond the stipulation in determining as to what extent there was curtailment——

Mr. Mackay: I object.

Mr. Melville: I am sorry. I have not finished.

The Court: You may complete your question, then I will hear the objection before the witness answers. Read the question, please, Mr. Reporter.

(The question was read.)

Mr. Melville: In the Dominguez Oil Field, in order to arrive at an opinion as to the fair market value of *the* [789]

Mr. Melville: That is all.

The Court: Are you through with Mr. Paine, now? May he be excused from further attendance as far as this case is concerned?

Mr. Mackay: Yes, he may.

Mr. Melville: Yes, your Honor.

The Court: Very well.

Mr. Melville: Now, your Honor, the Respondent's case is in except for the matter of the minutes of the directors and stockholders meetings of the Dominguez Estate Company, Francis Land Company, Carson Estate Company, and Reyes Dominguez Company, as to which it is hoped by us counsel can reach an agreement; secondly, the matter of sales and gifts of the various stocks, Dominguez Estate Company stock, Francis Land Company

(Testimony of Paul Paine.)

stock and the Carson Estate Company stock, over a period of years from 1935 to 1941, and as to those it is quite possible that opposing counsel can reach an agreement and stipulate. I, therefore, suggest, your Honor, that we adjourn this case until the latter part of next week.

The Court: Very well. We may be off the record for the time being.

(Discussion off the record.)

The Court: The record may show, Mr. Reporter, that we suspend at this time. The court is suspending until 9:30 Monday morning, but so far as this case is concerned it will [790] agreed future income in the Dominguez Estate Company case?

Mr. Mackay: If your Honor please, I object to that, it seems to me that that question is entirely beyond the pale of cross examination. It is too general, too indefinite, and just asking this witness——

The Court: Oh, I am inclined to think so. We seldom permit one witness to appraise the value of another witness' testimony.

Mr. Melville: Your Honor, this witness voluntarily and without any response to a question on my part, voluntarily stated that he referred to it in order to impeach Mr. Grimes' testimony. That is an opinion.

The Court: Well, that is an opinion which we will ignore, but we are not going to try one witness by the testimony of another witness. We are try-

(Testimony of Paul Paine.)

ing a lawsuit. We are interested in the value of property, and not in what Mr. Grimes might think of Mr. Paine's testimony or vice versa.

Mr. Melville: I am terribly sorry, your Honor, but I didn't hear the last of your Honor's remarks. Has your Honor ruled on the question.

The Court: I sustain the objection to the question as phrased.

Mr. Melville: No more questions.

Mr. Mackay: That is all.

The Witness: May I—— [791]

Mr. Melville: That is all.

The Court: Are you through with Mr. Paine now? May he be excused from further attendance as far as this case is concerned?

Mr. Mackay: Yes, he may.

Mr. Melville: Yes, your Honor.

The Court: Very well.

(Witness excused.)

Mr. Melville: Now, your Honor, the Respondent's case is in, except for the matter of the minutes of the directors' and stockholders' meetings of the Dominguez Estate Company, Francis Land Company, Carson Estate Company, and Reyes Dominguez Company, as to which it is hoped opposing counsel can reach an agreement; and, secondly, the matter of sales and gifts of the various stocks, Dominguez Estate Company stock, Francis Land Company stock and Carson Estate Company stock, over a period of years from 1935 to 1941, and as to

those it is quite possible that opposing counsel can reach an agreement and stipulate. I, therefore, suggest, your Honor, that we adjourn this case until the latter part of next week.

The Court: Very well. We may be off the record for the time being.

(Discussion off the record.)

The Court: The record may show, Mr. Reporter, that we suspend at this time. The Court is suspending until 9:30 Monday morning, but so far as this case is concerned it will [792] be called at 4:30 p.m. Monday evening, October 15, 1945.

(Whereupon, at 3:15 p.m., October 13, 1945, the hearing in the above-entitled matter was adjourned until 4:30 p.m., Monday, October 15, 1945.) [793]

PROCEEDINGS

October 16, 1945, 4:40 p.m.

The Court: We may be on the record in the Cotton and Caldwell cases. I think we have the appearances.

Mr. Melville: If your Honor please, at this time I desire to file amendment to the answer in the Victoria L. Cotton case, a copy of which I have previously given counsel for petitioner.

Mr. Mackay: May I take a look at it? I have got two copies here, and I just want to make sure it is the one I have.

The Court: The document may be handed to the clerk and will be filed as of this date.

Just a moment. Let's see if I understand what I am doing, however. You are offering at this time an amendment to the answer. I might ask counsel for the petitioner whether there is any objection.

Mr. Mackay: Your Honor please, I suppose this is in the form of a motion to file an amendment. That is the reason I spoke.

The Court: Well, generally there is a written motion. However, it may be an oral motion made in open court, which is the situation I suppose.

Mr. Melville: Your Honor, I formally move now for leave to file an amendment to the answer in the Cotton case.

Mr. Mackay: If your Honor please, I object to the motion to file the amended answer, because I think that your [797] Honor will observe the amended answer attempts to increase by a withdrawal of certain admission in the answer the deficiency asserted by the Commissioner of Internal Revenue. The Division, as I understand, your Honor please, is presumed to be correct, and that is what we are appealing from. The only way as I see that the counsel for the Commissioner may increase a deficiency over the one asserted is by affirmatively alleging facts which would justify the increased deficiency.

Now, this answer, if your Honor please, strikes out—or I mean the motion proposing an amended answer strikes out the last paragraph of the answer, which is the last paragraph on page 1. Now, it

seems to me it is quite inappropriate for the Commissioner of Internal Revenue at this time to come in and withdraw his admission with respect to the allegations in the petition, and that is one of the reasons I object. The other is that what he is trying to deny now is the specific exemption which is alleged prior to the year 1940. Now, if your Honor please, the deficiency was based, or the Commissioner's claim of deficiency, as I stated a moment ago, is presumed to be correct. Now the Commissioner in his proposed amended answer, after trying to withdraw is in effect denying the basis for the deficiency, in his prayer he states "Wherefore, the respondent prays that the court redetermine the deficiency herein to be the [798] amount determined by the Commissioner, viz., \$7,845.75, plus an increased deficiency in an amount sufficient to conform to the proof with respect to the amount of specific exemption used by the petitioner prior to the year 1941, claim for which is hereby made pursuant to the provisions of Section 272(E) of the Internal Revenue Code."

If the Commissioner has any idea of increasing that deficiency, he must do that affirmatively, the Commissioner having already determined the deficiency based upon information set forth in our petition and the Commissioner himself, who brought us in here. If the Commissioner were now claiming certain things in the stipulation, that the value was different, that is something else. As it stands here though, if your Honor please, it is just entirely improper for such an amendment to be ac-

cepted. I have never seen in my whole experience before the Tax Court any practice whereby the Commissioner has been permitted to withdraw the denial and have an increased deficiency. That can only be done, as your Honor well knows, by setting forth specific allegations. For this reason I object to the motion to file.

Mr. Melville: What this motion is about, your Honor, is simply this: That at the time the original answer was filed the respondent did not have in his possession certain facts with respect to transfers of stock by the petitioner. I learned only last Saturday from one of counsel [799] for the petitioner that some transfers which I didn't know at the start were gifts or sales, I learned Saturday that they were gifts, and thus it raises a question about the prior transfers by way of gift which enter into the method of computing the deficiency in this case, so I feel that the government's interests need to be protected by withdrawing the previous admission with respect to prior gifts and denying them, thus raising the question which will be open to proof, as to what the prior gifts were.

Then if the proof is different than alleged in the original petition, then I feel it is in accordance with the court's rules that we can ask for an increased deficiency to conform with the proof.

The Court: Well, I think I will deny the application at this time to file a further answer. We have been trying here a gift tax, the issue in controversy being the value of the property transferred during the particular taxable year or years by gifts.

In computing the amount of the gift tax, gifts made in prior years clearly constitute one of the factors. So far as I know there has been no controversy raised as to those factors, and certainly none of the proof has been directed toward them. It may be that incidentally in the trial of the valuation issue some evidence may have indicated that perhaps the Commissioner should have increased the gifts of the prior years. Since he did [800] not do so, that of course is not an issue in the original proceeding. I think it would be rather poor practice for us, at practically the close of all of the evidence and after the petitioner had rested, to unsettle pleadings and have an amendment to the answer made, the effect of which would be to raise an entirely new issue. So I will deny the motion to file an amendment to the answer in the Victoria L. Cotton case. You may if you desire it part of the record let the amendment to the answer be lodged with the clerk, and it may be marked as lodged. If you desire to supplement the record by filing a written motion, you may do so, but I don't think it is necessary.

Mr. Melville: May I have an exception, your Honor?

The Court: Exception will be noted to the court's ruling. This may be marked as lodged by the clerk, not filed.

Mr. Melville: Your Honor, at this time I should like to move for permission to file in the Caldwell case an amendment to the answer. Now, if your Honor please, this does not change the issues that are involved in the proceedings in any way at all.

The purpose of this motion and the purpose in filing the amendment to the answer, your Honor, is to test a question of law. It is the respondent's position that it is material to this case if we can show that there were sales of this stock over a period of time prior to and including [801] the taxable year at a rather consistent price. In order to prove that, I would have to call in a number of witnesses and each one of them could be stopped from telling his story on the ground that it is not material, then we would have taken up the time of this court and the time of a lot of witnesses in an attempt to do something which can be tested by my filing at this time an amendment to the answer alleging these sales. It is my understanding that a proper motion will be made by Mr. Mackay and we will test the legality of this type of evidence. Do you have any objections if this is filed, Mr. Mackay?

Mr. Mackay: Yes, sir.

The Court: Well, the nature of the matter that I am now being asked to rule upon is your motion for leave to file an amendment to the answer in the Caldwell case?

Mr. Melville: Yes, your Honor.

The Court: And the proposed amendment to the answer has been handed to the clerk and may be marked as lodged with the court on this date at the hearing.

Now, upon the ruling on the motion does counsel for the petitioner desire to be heard?

Mr. Mackay: Yes, your Honor. I object to the filing of the answer, in opposition to the motion,

for many reasons. In the first place, counsel has stated to your Honor that it does not raise any new issue in the case. [802] That, to my mind, is fatal. I object to it further on the ground that what is alleged in the answer has no bearing whatsoever or any materiality or relevancy to the issue in this particular case, and certainly is not part of proper pleadings.

Directing, if your Honor please, your attention to the nature of the proposed answer, it says:

“Paragraph VII. That during the period from 1935 to 1941, inclusive, there were transfers of the common stock of the Dominguez Estate Company in amounts ranging from a fraction of a share to 1,100 shares, and that the transferrers as well as the transferees consistently placed a value of \$1,000.00 per share on said stock, whether transferred by way of sale or by way of gift and whether transferred at arm's length or otherwise.”

Now, the next paragraph is in exactly the same terms, if your Honor please. It relates to the common stock of the Francis Land Company. Now, it seems to me it raises no issue in this case, that the issue in this case is the fair market value on June 5, 1941, of these various stocks. It just seems to me that the proposed answer has no place here. It merely says that somebody somewhere somehow transferred and the transferee and the transferrer consistently placed a value upon the said shares, whether that was made [803] at arm's length or

otherwise. Now, if your Honor please, that sort of allegation or statement of facts has no place in any pleading, and I am sure that even if the facts were true it has no bearing or relevancy on the issue here. Your Honor is well familiar with the rule of law that if a sale is to be considered as having any value or any bearing upon a particular time or to determine value any particular date, the conditions I think must be given. If they just sold securities not reported in this statement and consistently did it and they had made communications this way and that way, whether it was all at arm's length or not, what would we gain by allowing such testimony in or even considering it?

In view of all the circumstances, if the court please, I object to the motion to file the proposed amended answer.

Mr. Melville: Your Honor, I think I correctly stated that it does not raise any new issue. The issue in the case from the beginning has been the fair market value of the stock in these three family corporations.

I am prepared, if necessary, to bring into court 10, 20 or 30, or any other number of witnesses to testify that they sold this stock at \$1,000.00 or \$1,100.00 a share. I was trying to avoid the necessity of bringing in all these witnesses, and I thought it was understood between Mr. Mackay [804] and myself that I would file such an amendment to the answer and we would test the question of the materiality of these sales. If your Honor should rule that such sales are material, then it is my

understanding that Mr. Mackay does not dispute the facts, would admit them, and we could avoid bringing in all of these witnesses. Whereas if your Honor denies the respondent the right to file this amendment on some of the grounds other than materiality, it would of course force the respondent to bring in his witnesses and at that time test the materiality of these prior sales.

I wish to comment a little about Mr. Mackay's reference to the fact that generally someone at some time sold someone and so forth. I have here a very lengthy answer to the petition in which I go into great detail. Mr. Mackay has a copy of that, so there is no question in his mind as to who the sales were to and who the sales were from.

Now, the last point I would like to make is this: The best evidence of fair market value of the stock is the price that it will bring in actual trading. I believe further, your Honor, that actual sales that I am in a position to establish pursuant to my allegations here would be in the nature of rebuttal at least. Some of the petitioners expert witnesses on stock valuation testified that it would change their opinion if they knew that actual sales had been made.

In closing, your Honor, I do not believe that it would be necessary for the respondent to amend the pleadings in any respect in order to get in the evidence with respect to these sales. I could simply have the witnesses in court, put them on the stand, go through the formality of questioning them, even though maybe their testimony, I appreciate, could

be objected to on the ground of immateriality. We are trying to avoid, as I said before, the necessity of doing that. I am not trying to file this amendment in order to change the issues or really to change the pleadings. That is not necessary for the respondent to allege affirmatively that sales were made. I have the privilege of producing evidence to that effect. I want to lay the groundwork for it, so that if your Honor rules that if these sales are material to the issue in the case, then I have reason to believe that Mr. Mackay will stipulate the facts. He knows the facts and I think we could get together on a stipulation, if your Honor rules that they are material.

Mr. Mackay: If your Honor please, I just want to make this observation. Mr. Mackay is not suggesting what the Commissioner should attempt to do, but for the enlightenment of the court, since counsel referred to it in his proposed amended answer, I might state that Mr. Mackay thoroughly disputes for the record any sale being made. I do not dispute the fact that under compromise settlement with certain attorneys that a certain price was paid—I want to [806] withdraw that, not that a certain price was paid, but if the government wants to show all the circumstances with respect to that, let them show that what they call sales were sales from a mother to her daughter for a note without interest taking 20 years to pay and paying it only out of dividends. I want to make it quite clear that Mr. Mackay is not admitting for the purpose of the record that there are any sales at all of these

stocks that would give the court any help upon the question here involved. Since counsel frankly admitted to the court that he is not raising any issue, of course, there is nothing for the court to do but to deny the motion.

The Court: Well, the court has considerable difficulty in ruling correctly upon the motion. Every indication has been given that counsel for both sides have commendably endeavored to shorten the trial.

The cases have already taken a week, however, for trial, and apparently the respondent is desirous of introducing additional evidence pertaining to or showing sales made at a time anterior to certainly the transactions in suit, the weight of course to be given to the evidence necessarily being contingent upon various factors. The relationship of the parties engaged in such a transaction would be pertinent and might be entitled to some weight. I think the time when those sales were made, particularly with reference to the time that the gift or gifts in issue [807] were made, would be pertinent and necessarily a factor to be taken into consideration by us in determining the weight to be given the evidence.

So I am confronted with a difficult situation to rule upon, when I am asked perhaps in an effort to shorten the trial, which is commendable on the part of counsel, in effect to rule upon the competency, materiality and relevancy and weight to be given certain evidence of which I have none but the vaguest notion, so far as the proposed amendment is concerned, and I would think that it is

probably not proper. Then in saying that I do not intend to imply or infer any criticism of counsel for offering it.

My own judgment is, gentlemen, that if you succeed in getting together upon the substance of the testimony which either side may desire, that is the additional testimony, my general understanding being that it consists in part of corporate minutes, resolutions of stockholders and directors, returns made by parties litigant before the court and by others—if you gentlemen succeed in agreeing upon those exhibits and presenting them in a short form, I have no alternative but to rule piecemeal upon all of the evidence as it is presented, so the motion to file the amendment to the answer will perforce be granted and we will reopen the proceeding immediately upon the conclusion of the trial of the two cases which have been assigned rather [808] definitely for trial and one of which is now in the process of trial.

In other words, about all I can say at this time is that we will suspend in the trial of the Caldwell and Cotton cases until we have concluded the trial of those two cases, which will probably be by Thursday of this week.

Mr. Melville: I would like to know if your Honor could give me a specific time. I may have to get out subpoenas in this case, and I would like to order these people into court at such time as your Honor feels it would not interfere too much with any case which is pending.

The Court: I don't believe I would attempt to

take that responsibility at this stage. You know as much about it as I do, and I say that without being critical. We are in the midst of the trial of the Powell case which originally was estimated to take two days and which has already taken two days. It is obvious that the trial of the Powell case will take some additional time, just how much I am not prepared to make any reliable estimate. The Neil case was set heretofore on the calendar to follow the Powell case, and those folks are waiting. They have estimated that it will take a day to try the Neil case.

Now, anything can happen overnight. All these cases may be settled or disposed of, so I would prefer just to let you gentlemen take your chances now.

Mr. Mackay: I might say this for the record, that counsel for the petitioner will see that any witness counsel for the Commissioner wants will be produced within reasonable time. I think I can get them in very promptly.

Mr. Melville: I will furnish you a list tomorrow, Mr. Mackay.

Mr. Mackay: Who is that, the Carsons and the Watsons?

Mr. Melville: The whole family.

Mr. Mackay: Well, anybody connected with the family, if they are in town, I will see that they are here for you, if you want them, without a subpoena.

Mr. Melville: Thank you, sir.

(Whereupon, at 5:15 p. m., a recess was taken to 3:30 p. m., Friday, October 19, 1945.)

PROCEEDINGS

October 19, 1945, 3:30 p. m.

The Court: Are you ready, gentlemen?

Mr. Melville: Your Honor, Respondent's Exhibit BB was withdrawn with leave to substitute a photographic copy. I believe I now have another extra copy which Mr. Arnold kindly found for me, and at this time I will file it.

Mr. Mackay: What is that, a report of what?

Mr. Melville: Report to stockholders dated March 25, 1941.

The Court: I think CC was the one that was to be furnished, a copy of the minutes.

Mr. Melville: Here it is, your Honor, copy of the minutes of the stockholders dated March 28, 1940.

The Court: That is CC, isn't it?

Mr. Melville: Yes, your Honor.

The Court: Then that will be received as Respondent's Exhibit CC.

Mr. Mackay: If your Honor please, may I check the record on that? That is a report to stockholders, is it not?

Mr. Melville: That is right.

Mr. Mackay: And that is dated when?

Mr. Melville: March 28, 1940.

The Court: Both of them, there was BB and CC marked as report to stockholders.

Mr. Melville: That was for the following year, [814] March 25, 1941, your Honor.

The Court: Oh, I see. This one is for a different year.

Mr. Melville: That is correct, your Honor.

The Court: Very well.

Mr. Melville: I offer at this time a report to stockholders covering the period preceding the meeting of the stockholders on April 14, 1937, presumably covering the 12 months previous.

Mr. Mackay: If your Honor please, as to that particular year, it is improper for them to go into this, and I think it is irrelevant and immaterial; therefore I object to it.

The Court: I am not sure I have followed just what you are doing here.

Mr. Melville: Your Honor, when Mr. Cotton was on the stand I was having him identify certain paragraphs in connection with laying a foundation for offering part or all of this report to stockholders in evidence. In order to save time I am willing to offer the entire report in evidence, because there are parts three which deal with the condition of these companies in 1936 and up to 1937. I will be glad to put Mr. Cotton back on the stand now and have him identify them, if that is necessary.

Mr. Mackay: No, you misunderstand me. I am [815] admitting that this is a true copy of a report to stockholders, but I am objecting to its relevancy and materiality.

The Court: This is one that we have not heretofore talked about or put in evidence, is that correct?

Mr. Melville: I had it marked for identification, your Honor. I was asking Mr. Cotton when he was

on the witness stand with respect to certain paragraphs of this.

The Court: I am only trying to reconcile or get my own recollection tied in with my notes here. Now I note on my memoranda, which are rather sketchy, that there was a document apparently having something to do with the minutes which was marked as Respondent's Exhibit DD, and then there was an excerpt read from the books, and the document itself which had been marked was not received in evidence.

Mr. Melville: This is it, your Honor.

The Court: And this is a copy of that, is that correct?

Mr. Melville: That is correct, your Honor.

The Court: Now, we have in the minutes themselves a marking as Respondent's Exhibit DD, marked for identification under date of October 12, 1945. Will it be then agreeable that we simply strike out the other marking and mark this particular document as Respondent's Exhibit DD for identification?

Mr. Mackay: Quite right. [816]

Mr. Melville: Quite agreeable. That permits them to keep the document in the book.

The Court: You may draw your pen through the marking, Miss Mies, and then re-mark the document which has been handed to you. It may be marked for identification as Respondent's Exhibit DD.

Now, your objection, Mr. Mackay?

Mr. Mackay: It is that it is irrelevant and immaterial.

The Court: Very well. The objection will be overruled and we will receive it, and if it has no materiality it will be ignored.

(Thereupon, the documents heretofore marked as Respondent's Exhibits CC and DD, respectively, were received in evidence.)

[Exhibits CC and DD are set out in full in Book of Exhibits.]

Mr. Mackay: May the record show an exception?

The Court: Exception may be noted.

Mr. Melville: Your Honor, I have a copy which was kindly made for me by Mr. Arnold of certain paragraphs out of the minutes of the directors' meeting of the Carson Estate Company on May 6, 1936, together with a copy of the notice of a special meeting of shareholders which is referred to in said minutes. I offer those as one document in evidence.

Mr. Mackay: May I take a look at it just a minute?

If your Honor please, we admit of course that these [817] are correct documents, but I want to call your Honor's attention particularly to the content of this before your Honor rules upon it. The minutes of the May 6, 1936, meeting, which are now proffered, merely authorize another new voting trust. I would like your Honor to examine it. It does seem to me that the minutes in this book, back almost six years, have to do only with the particular voting trust, and would have no materiality or relevancy to the issue involved in this case, and that

is the reason why I objected to it on the ground it is irrelevant and immaterial; it can have no bearing upon the value in 1941 whatsoever.

Mr. Melville: Your Honor, much has been said by witnesses, particularly the expert witnesses of the petitioner, with respect to minority interest and stockholder control and so forth. I wish the record to show when this case is finally submitted that the stockholders of the Carson Estate Company through a voting trust agreement controlled absolutely during the taxable year 1941 the Francis Land Company, and the significance of that can be readily understood if your Honor would refer to the chart showing the intercorporate relationships. I think it is material.

Mr. Mackay: If your Honor please, the stockholders always control the corporation.

Mr. Melville: They not only control the Carson Estate Company, but they control the Francis Land Company. [818]

Mr. Mackay: For their purposes, maybe. Of course, whether that is right or not, I think it is entirely irrelevant and immaterial and has no bearing upon the values here.

The Court: Well, I am inclined to think that it may have some materiality, in view of the testimony which has been adduced with reference to the discount to be applied to evaluating minority interests. It may have some materiality.

Mr. Mackay: May I interrupt the court to make a further objection to it, unless the voting trust to which it refers is brought forth.

Mr. Melville: No objection, your Honor. We are not trying to withhold any evidence.

Mr. Mackay: I don't want it introduced as my exhibit, if your Honor please.

The Court: I think we can properly receive it,——

Mr. Mackay: I want the record to show——

The Court: ——as part of the whole transaction, so that we will receive these three documents. I think I will mark notice of special meeting of stockholders of the Carson Estate Company as Respondent's Exhibit II, and the document containing the minutes of May 6, 1936, of the Carson Estate Company as Respondent's Exhibit JJ, and in order to complete the record the voting trust agreement relative to [819] capital stock of the Francis Land Company as Exhibit KK.

Mr. Mackay: May the record show an objection to each one of those on the ground that they are irrelevant and immaterial.

The Court: The objection will be overruled.

(Thereupon, the documents referred to were marked as Respondent's Exhibits II, JJ, and KK, respectively, and were received in evidence.)

[Respondent's Exhibits II, JJ, and KK set out in full in Book of Exhibits.]

Mr. Mackay: Please note an exception.

The Court: Exception may be noted.

Mr. Melville: Your Honor, I have copies that were made for me by Mr. Arnold giving extracts

from the minutes of the Reyes-Dominguez Company, which meetings were held on December 12, 1935, and April 9, 1936.

Mr. Mackay: Wait a minute, Mr. Melville, until I can follow you.

Mr. Melville: May 13, 1936, and September 11, 1936. I offer those in evidence.

Mr. Mackay: If your Honor please, I object on the ground it is irrelevant and immaterial.

The Court: I am not sure that I recollect anything about the Reyes-Dominguez Company. We have been, it seems to me dealing in this case with the Dominguez Company.

Mr. Melville: That is correct, your Honor.

I might state that before I am through offering [820] documents here I will offer a stipulation of facts which I think will clear up the relationship of the Reyes-Dominguez Company.

The Reyes-Dominguez Company was an organization that among other things purchased 1,100 shares of Dominguez Company stock from the Title Insurance & Trust Company—or pardon me, from the O'Melvenys, and 365 shares of Francis Land from the Title Insurance & Trust Company trust of Mrs. Francis.

The Court: Well, it may be that the whole matter will be connected. I was only making the observation that I hardly knew the connection.

Suppose we mark the document at this time for identification as Respondent's Exhibit LL, and I will see if I can more intelligently rule upon the offer when I know more about it.

(The document referred to was marked for identification as Respondent's Exhibit LL.)

Mr. Melville: Your Honor, I have a document here which contains extracts from the minutes of the directors' meeting of the Dominguez Estate Company, which meetings were held on April 10, 1935, June 19, 1935, May 7, 1936, May 13, 1936, May 25, 1936, but inasmuch as I have only asked for extracts from those minutes and Mr. Mackay says if they go in at all he would prefer to have the entire minutes, I have here the entire minutes of May 25, 1936, and July 29, 1936, and I offer in evidence both documents as respondent's next exhibit.

The Court: They may be marked for identification as Respondent's Exhibit MM.

Mr. Mackay: Just for identification.

The Court: Very well, mark them for identification as Respondent's Exhibit MM, and perhaps to keep them separate we had better mark that document as prepared by counsel for the Government MM-1 and the document supplemental to it as MM-2. You had something to say, Mr. Mackay?

Mr. Maackay: My only point is that I had merely asked counsel to put in all the minutes with respect to May 25th. I don't want the record to infer that I am offering them in evidence.

The Court: I think I understand, and I don't believe you will be charged with anything. You probably are in the position that you object to receiving a portion of the minutes for that year. [822]

Mr. Mackay: That is right, rather than suggesting that any meetings——

The Court: You think it should be the whole.

Mr. Mackay: That is right. I just want to be sure my objection goes to that.

The Court: I think I understand your objection. I mean, I think the record is clear on that. But we will identify MM which consists of two parts, MM-1 and MM-2 as identified.

(The documents referred to were marked for identification as Respondent's Exhibits MM-1 and MM-2.)

Mr. Melville: Your Honor, at this time I offer a stipulation, the original and two carbon copies thereof, and attached to the original and to one carbon copy are three invoices. The stipulation is a stipulation entered into by Mr. Mackay and counsel for the respondent dealing with certain sales of the various stocks that are involved in this case.

Mr. Mackay: If your Honor please, I entered into this stipulation, reserving the right to object to the statements and to the stipulation on the ground of irrelevancy and immateriality.

The Court: In other words, the essence of your objection, I take it, would be that you admit that the facts are facts, but that they have no materiality to the controversy.

Mr. Mackay: That is right, irrelevancy. [823]

The Court: Or relevancy. The stipulation may be handed to the Clerk, will be filed of this date and will constitute a part of the record.

Mr. Mackay: Please note an exception.

The Court: Why would you except to that ruling?

Mr. Mackay: Well, maybe I didn't understand your Honor.

The Court: You prepared and handed me a stipulation and I only received it for filing as part of the record.

Mr. Mackay: Oh, I see. Well, I want the record to show that I object to the relevancy and materiality of what is stipulated.

The Court: I am not ruling upon either.

Mr. Mackay: I see.

The Court: I will have to reserve that until I analyze it and see.

Mr. Mackay: That is quite agreeable.

Mr. Melville: I will call Mr. Hill.

HARRY K. HILL,

called as a witness for and on behalf of the respondent, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: Your name for the record, please.

The Witness: Harry K. Hill.

By Mr. Melville:

Q. Mr. Hill, what is your business?

A. Certified public accountant.

Q. How long have you been engaged in that business?

A. In public accounting since 1920.

(Testimony of Harry K. Hill.)

Q. Here in Los Angeles? A. Yes, sir.

Q. Did you ever do any accounting work for the Dominguez Estate Company?

A. Yes, sir.

Q. The Francis Land Company?

A. Yes, sir.

Q. The Carson Estate Company?

A. Yes, sir.

Q. When did you discontinue doing the accounting work for those companies?

A. Well, for Carson Estate Company I can't recall. It must have been in 19—probably in 19—about 1925. That is—well, around 1925 or 1926. I don't recall exactly,—

Q. Well, Mr. Hill, did you work for, do accounting work for the Dominguez Estate Company since the O'Melvenys were not connected with it?

A. Yes, sir.

Q. And for any length of time thereafter? [825]

A. Well, I did some work after—after I suppose they were not connected with the company, yes, sir.

Q. You knew Mr. H. W. O'Melveny?

A. Yes, sir.

Q. Did he ever call upon you to furnish him with financial statements of the condition of the Dominguez Estate Company? A. Yes, sir.

Mr. Mackay: I object. Oh, you answered that?

The Witness: I said yes, sir.

By Mr. Melville:

Q. Did he call on you for financial statements

(Testimony of Harry K. Hill.)

during 1935 and during the spring of 1936?

Mr. Mackay: I object to that, if your Honor please. It is a suggestive question in the first place, and besides it is irrelevant and immaterial.

The Court: Well, I am a little bit confused as to the years. I thought he was talking about 1925. He said 1925 a while ago.

Mr. Melville: He said, your Honor, that he did some work for the Carson Estate Company in 1925. The record will show, the stipulation that we have filed, your Honor, will show that the O'Melvenys were put out in long about May 8, 1936, and this witness has testified that he did accounting work for the Dominguez Estate Company up to and including that [826] time and for a short period of time thereafter.

Mr. Mackay: Now, if your Honor please, I want the record to be unchallenged and free of question. If we go into the O'Melvenys it is a long story, and the facts are stipulated. I think that will be enough to protect my record.

The Court: Well, I had not understood him to say that he had been in the work of accountant for these companies in 1936. But that is a fact that you were, is that correct?

The Witness: That is correct, yes.

The Court: Very well.

Mr. Melville: What was the last question? Has it been answered?

The Court: The question was whether he had

(Testimony of Harry K. Hill.)

prepared some reports in 1936. Did you want all the question read back?

Mr. Melville: I believe we had better have it to show what has been ruled upon.

(The question was read.)

Mr. Mackay: I object to it on the ground it is incompetent and irrelevant and immaterial, what this accountant did in 1936 for H. W. O'Melveny.

The Court: I don't know how competent it may be. We are dealing here with the years much later, but if it is not connected up we will, of course, ignore it. You may proceed with the examination. He may answer yes or no. [827]

The Witness: Yes.

By Mr. Melville:

Q. Do you of your own knowledge know whether Mr. O'Melveny kept constantly abreast of the financial condition of the Dominguez Estate Company?

Mr. Mackay: If your Honor please, I object to that as a suggestive question in the first place, and besides it is entirely irrelevant and immaterial. He is not in a position to state the condition of the mind of Mr. O'Melveny whether he was abreast or whether he was away off. Whether he was away off or whether he was abreast is not personally known to him.

The Court: The objection will be sustained to the question as phrased.

(Testimony of Harry K. Hill.)

By Mr. Melville:

Q. Did you have discussions with Mr. O'Melveny or he with you about the value of the Dominguez Estate Company stock? A. Yes.

Q. When?

A. Well, at various times over a period of years. I couldn't tell you the dates.

Q. You know, do you not,—excuse me. I will withdraw that.

Mr. Mackay: Thank you, Colonel.

By Mr. Melville: [828]

Q. Mr. Hill, what was the nature of the reports that you gave Mr. O'Melveny?

Mr. Mackay: I object, if your Honor please, entirely incompetent, irrelevant and immaterial to anything in this case.

The Court: In a general way he may state the nature of the reports.

Mr. Mackay: Maybe I am anticipating. I think you are right.

The Witness: Well, largely—at the end of the month he was given a statement, what we call a balance sheet, a profit and loss statement, and those were statements made according to the books and according to the records that we had.

By Mr. Melville:

Q. Did he continue to receive those statements as long as he remained connected with the Dominguez Estate Company?

(Testimony of Harry K. Hill.)

A. Well, I would like to—I couldn't say that it was our practice to make them every month, but it is possible that there may have been occasions when they were not made exactly at the end of the month, and on the other hand, frequently we made special reports for him and for the company.

Q. Do you know whether or not he received such a report of the condition of the Dominguez Estate Company at the time that the sale of 1100 shares of the Dominguez Estate Company [829] stock to the Reyes-Dominguez Company was being considered?

Mr. Mackay: I object to that, if your Honor please, as a leading question. It is also suggestive and besides it is irrelevant and immaterial.

Mr. Melville: Your Honor, the purpose of this question is material. The record will show that there was a sale of 1100 shares of Dominguez Estate Company stock from the O'Melveny family to the Reyes-Dominguez Company at \$1000.00 per share. I want the record to show that that was not some figure picked out of thin air, as one of the petitioners' expert witnesses said, and I want to show that the figure was based upon facts which Mr. O'Melveny knew, and that he was well familiar with the financial condition of those companies.

Mr. Mackay: If your Honor please, if that was the purpose, then, of course, that is clearly objectionable and I certainly do object on the ground that it is incompetent, irrelevant and immaterial.

The Court: I am not sure that I understand just

(Testimony of Harry K. Hill.)

what you are attempting to go into. I think I would permit you to show the general practice as it existed along at the time the sale was made, of furnishing to the seller or to someone connected with these companies comparative statements or balance sheets, receipts and disbursements and profit and loss, but I don't think that it would be competent to receive those documents themselves in evidence. [830]

Mr. Melville: I am not offering those, your Honor.

Mr. Mackay: I asked him to direct this witness how he arrived at that, what he did and how he determined it.

Mr. Melville: This is a certified public accountant doing work for the O'Melvenys.

The Court: Let us hear the last question, please, Mr. Reporter.

(The question was read.)

The Court: Well, do you know when the sale that counsel is referring to took place?

The Witness: The exact date, no, I don't. I know all about it, approximately it was in 19—sometime in 1936. I would say that it was sometime in May or June, but I can't remember the exact date, and as a matter of fact, I don't know that I ever did know the exact date.

The Court: Well, in a general way, I will permit you to answer the question, as to whether you

(Testimony of Harry K. Hill.)

were still giving balance sheets of those reports along about the time when the sale was made, if one was made.

The Witness: Yes.

Mr. Melville: No more questions.

Mr. Mackay: That is all.

The Court: You may stand aside, Mr. Hill.

(Witness excused.)

Mr. Melville: Will you take the stand please, Mr. [831] Cotton. I would like to resume my direct examination.

The Court: This witness was sworn before, wasn't he?

Mr. Melville: Yes, your Honor.

The Court: And testified. Very well.

HENRY HAMILTON COTTON,

recalled as a witness for and on behalf of the Respondent, having been previously duly sworn, was further examined and testified as follows:

Further Direct Examination

The Court: Now, let me see. On the record we are doing what? Have you called the witness for further cross examination?

Mr. Melville: The witness that I stopped, on your Honor, at one time, because I had an expert witness waiting in Court, and asked leave to defer his examination, as you recall.

(Testimony of Henry Hamilton Cotton.)

Mr. Mackay: To clear up the record, Mr. Cotton was called by counsel for the Respondent.

Mr. Melville: That is right, and I am renewing the direct examination.

The Court: Then he is your witness?

Mr. Melville: Yes, your Honor.

The Court: Very well. [832]

By Mr. Melville:

Q. Mr. Cotton, referring to the voting trust agreement which the Watson Land Company and the Carson Estate Company entered into during 1936, did that voting trust agreement remain in effect throughout 1941? A. Yes, sir.

Q. Referring, Mr. Cotton, to the minutes of the directors' meeting of the Dominguez Estate Company dated May 25, 1936, wherein it was decided to put up for consideration of the stockholders the matter of purchasing not to exceed 499 shares of the stock at a price not exceeding \$1000.00 per share, I ask you, Mr. Cotton, if the stockholders met on May 25, 1936, and if so, whether or not they approved that plan?

Mr. Mackay: Now, let me get the question. Was that with respect to the reduction of the stated capital, Mr. Melville?

Mr. Melville: That was one of the points that was taken up at that special meeting.

Mr. Mackay: Yes.

Mr. Melville: I may state, your Honor, that the minutes of the directors' meeting show that they

(Testimony of Henry Hamilton Cotton.)

called a special meeting of the stockholders, but there is not in the book any record of the stockholders' meeting, although the directors met on the same day, May 25th, and proceeded as though there had been a stockholders' meeting. I just want [833] to clear it up, as to whether or not there was a stockholders' meeting pursuant to that plan and what action they took.

The Court: You mean the stockholders' meeting? May I just get it straight in my own mind? Do you mean the stockholders' meeting to reduce this stated capital, or do you mean regarding the purchase of shares? I am becoming a little confused there. We may be off the record a moment.

(Discussion off the record.)

The Court: Are we ready to proceed, gentlemen?

Mr. Melville: Yes, your Honor.

By Mr. Melville:

Q. Referring, Mr. Cotton, to the minutes with respect to the possible purchase of 499 shares of stock at \$1000.00 per share——

A. Not exceeding.

Q. ——not exceeding \$1000.00 per share, thank you, did you ever hold a meeting of the stockholders with respect to the purchase of those shares of stock?

A. We never did, and we never purchased any.

Mr. Melville: Thank you. You may cross examine.

(Testimony of Henry Hamilton Cotton.)

Your Honor, this is the last witness which Respondent is calling, and before I turn him over to Mr. Mackay for cross examination of this witness, I will resume my offer in evidence of what has been marked as Respondent's Exhibits LL, MM-1 and MM-2. [834]

Mr. Mackay: Let's offer just one at a time, so I can get the record clear.

Mr. Melville: I offer at this time Respondent's Exhibit LL.

Mr. Mackay: If your Honor please, I object to that as irrelevant and immaterial.

The Court: Well, I don't know whether it has any relevancy or materiality. I will have to dovetail it in with these minutes which have been received, and which I have, of course, not had an opportunity to examine. I will, however, overrule an objection and receive it for what materiality, if any, and relevancy it may have or be determined to have when we go to inquiring into the whole matter.

Mr. Mackay: That is quite agreeable.

The Court: So we will receive the document which has heretofore been marked for identification as respondent's Exhibit LL.

(The document which was heretofore marked as Respondent's Exhibit LL for identification, was received in evidence.)

[Respondent's Exhibit LL set out in full in Book of Exhibits.]

(Testimony of Henry Hamilton Cotton.)

Mr. Melville: At this time I want to resume my offer of what has been marked for identification as Respondent's Exhibit MM-1.

Mr. Mackay: Same objection, your Honor.

The Court: Same ruling. [835]

(The document heretofore marked as Respondent's Exhibit MM-1, for identification, was received in evidence.)

[Respondent's Exhibit MM-1 set out in full in Book of Exhibits.]

Mr. Melville: And in view of Mr. Mackay's statement that he wanted the entire minutes of May 25, 1936, to go in, I will offer as Respondent's Exhibit MM-2 what has been heretofore marked as Respondent's Exhibit MM-2 for identification.

The Court: Well, it will be received. I think I understand counsel's objection, namely, that if certain portions of MM-1 are to be received, that MM-2 too should be received rather than a page or so of MM-1.

Mr. Mackay: That is right, your Honor. I just don't want——

The Court: Objection overruled. You are not being charged with the responsibility of offering MM-2, but merely as objecting to the receipt of a portion, or MM-1.

Mr. Mackay: That is right.

The Court: And you are offering the same objection heretofore made with reference to LL. Both documents will be received in evidence.

(Testimony of Henry Hamilton Cotton.)

(The document heretofore marked as Respondent's Exhibit MM-2, for identification, was received in evidence.)

[Respondent's Exhibit MM-2 set out in full in Book of Exhibits.]

Mr. Melville: You may cross examine.

Cross Examination

By Mr. Mackay:

Q. Now, Mr. Cotton, referring to the minutes of the [836] board of directors of the Dominguez Estate Company, dated May 25, 1936, I call your attention to a statement in there in which the chairman states something like this:

"The chairman then read a letter from Del Amo Estate Company addressed to Dominguez Estate Company in which they offered to sell all or any part of their 980 shares of stock in the company for a price of \$800.00 per share."

I will ask you, Mr. Cotton, if the Dominguez Estate Company ever purchased this Del Amo stock.

A. They did not.

Q. Do you know why? A. Yes.

Q. Will you please state to the Court.

A. Because I advised the directors that the price was way out of line and too high. At the same time the directors authorized me to negotiate with the Del Amos as to the price of the stock. After talking it over with Mr. Del Amo, he finally withdrew his offer to sell.

(Testimony of Henry Hamilton Cotton.)

Q. Now, Mr. Cotton, I think you have stated, but I want to make sure, did the Dominguez Estate Company after this authorization in reducing its stated capital in 1936 ever purchase any of its own stock?

A. They did not. Now, I say that advisedly. I am pretty sure they did not. [837]

Q. Mr. Cotton, I call your attention to the report to the stockholders. I think it is dated May—March, 1940—I will reframe the question. I call your attention to Respondent's Exhibit CC, which is a report to stockholders of the Dominguez Estate Company dated March 28, 1940, and I call your attention particularly to the last paragraph of that, and more particularly to the reference to its appraised value, referring to the stock of the Dominguez Estate Company. I will ask you, Mr. Cotton, if there was ever an appraisal made of the stock of the Dominguez Estate Company prior to this suit?

A. Not to my knowledge.

Q. Well, what did you refer to when you were referring there to its appraised value, Mr. Cotton?

A. Well, I think that was rather an unfortunate word, its appraised value. It referred to my—was the figure that was set forth by the Government in their claim for taxes in the Francis Estate and on which tax was paid. That is the only thing we had an appraisal on.

Q. Now, I think you are speaking about the deficiency letter to the Francis Estate.

A. Yes, of 1934, I believe.

(Testimony of Henry Hamilton Cotton.)

Q. In about 1934. I see.

A. And in calling—can I follow up this just a moment—in calling my attention to the last paragraph I see [838] their ability to pay a return of 7.7 per cent on the basis of \$1000.00 per share, ability to pay it not particularly out of earnings but out of previous earnings, and surplus account. It was not out of earnings.

Q. I see. Now, Mr. Cotton, I will ask you to please state whether or not you know Huntzinger & Cosgrove? A. Attorneys, yes.

Q. Will you please state whether Huntzinger & Cosgrove were ever attorneys for the Dominguez Estate Company? A. No, I believe not.

Q. Were they ever attorneys for the Francis Land Company? A. No.

Q. Were they ever attorneys for the Carson Estate Company? A. No.

Mr. Mackay: You may take the witness.

Redirect Examination

By Mr. Melville:

Q. Mr. Cotton, you stated that this 7.7 per cent on the basis of \$1000.00 per share was not paid out of earnings but was——

A. No, I said not entirely out of earnings, but out of earnings and previous earnings and surplus.

Q. Do you have the books of the corporation here that [839] will substantiate your statement?

Mr. Mackay: We stipulated to that.

(Testimony of Henry Hamilton Cotton.)

The Witness: Mr. Arnold, have you any books here?

Mr. Mackay: We have a stipulation here.

Mr. Melville: Yes, but there is nothing stipulated, Mr. Mackay, that shows that they delved into surplus in order to pay the dividends.

Mr. Mackay: Why, sure.

The Court: Pardon me. Does the stipulation of facts show that the amount of dividends paid were in excess of the amount of earnings?

Mr. Mackay: Yes, your Honor.

The Court: Is that what you are referring to, Mr. Cotton?

The Witness: Yes, sir.

Mr. Melville: I think the stipulation will show that. No more questions.

Mr. Mackay: That is all.

At this time, I would like to offer, if your Honor please——

(Witness excused.)

Mr. Melville: Respondent rests.

The Court: So this will now be on rebuttal, will it gentlemen?

Mr. Mackay: Yes, your Honor. [840]

The Court: Very well.

Mr. Mackay: I will state for the record that Joint Exhibit 15-O shows the shareholders of the Carson Estate Company and in order to show their relationship to the Petitioners here we have re-copied Joint Exhibit 15-O and added the relation

to the Petitioner, and I should like to offer that at this particular time.

Mr. Melville: No objection, your Honor.

The Court: Pardon me just a moment. Apparently we have received on behalf of the Petitioners in this case some 28 exhibits; haven't we?

Mr. Mackay: Yes, your Honor.

The Court: So that this then may be marked as Petitioners' Exhibit No. 29, and I suggest that we better strike out of it the words Joint Exhibit 15-O appearing at the top here.

Mr. Mackay: Yes, your Honor. I am sorry. That is quite all right.

The Court: Very well. This will be received. Is there any objection?

Mr. Melville: No, your Honor.

The Court: This will be received as Petitioners' Exhibit No. 29.

(The document referred to was marked and received in evidence as Petitioners' Exhibit No. 29.) [841]

Mr. Mackay: I offer a similar statement with respect to the outstanding stock of the Francis Land Company. You have a copy of that, I think.

Mr. Melville: No objection, your Honor.

The Court: It will be received as Petitioners' Exhibit No. 30.

(The document referred to was marked and received in evidence as Petitioners' Exhibit No. 30.)

Mr. Mackay: And I offer a similar statement with respect to the stockholders of the Dominguez Estate Company.

Mr. Melville: No objection, your Honor.

The Court: It will be received as Petitioners' Exhibit No. 31.

(The document referred to was marked and received in evidence as Petitioners' Exhibit No. 31.)

Mr. Mackay: At this time I would like to call Mr. Wents.

The Court: This gentleman was previously sworn?

Mr. Mackay: Yes, your Honor.

JOHN H. WENTS, JR.

recalled as a witness for and on behalf of the Petitioners, having been previously duly sworn, was further examined and testified as follows:

Further Direct Examination

By Mr. Mackay: [842]

Q. Mr. Wents, have you prepared a map at my suggestion with respect to the drilling of wells on the Dominguez Estate property?

A. Yes, I have.

Q. Will you please explain to the court just what this map is, Mr. Wents?

(Testimony of John H. Wents, Jr.)

A. This is identically the same map as referred to before, with the leases marked on it.

The Court: Identically the same map as one of the exhibits attached to the stipulation of the parties.

The Witness: Yes.

The Court: Do you know which one that is?

We will be off the record a minute.

(Discussion off the record.)

The Court: The record may show that the map which has been placed on the board in the court room is substantially the same as Exhibit 17-Q, is that right, Mr. Wents?

The Witness: It is, your Honor, with the exception that Exhibit 17-Q is exactly to date June 5, 1941, but on this map there are shown certain wells which I will explain later which have been drilled subsequent to the date of June 5, 1941.

Mr. Melville: I object to going into anything that happened subsequent to June 5, 1941, your Honor, because a person appraising this stock as of that date could not possibly know definitely, could not know as definitely as Mr. Wents [843] knows what happened subsequent to June 5, 1941.

Mr. Mackay: If your Honor please, I have not offered the map in evidence yet. I am just trying to lay a foundation.

The Court: Well, I would suggest that—I don't anticipate that you are going to offer that map in evidence, are you?

(Testimony of John H. Wents, Jr.)

Mr. Mackay: I should like to, your Honor, when I lay a proper foundation. I think I can demonstrate in a very few minutes that it is perfectly proper for my limited purpose.

The Court: You may proceed with the examination of the witness.

By Mr. Mackay:

Q. Mr. Wents, I think you testified that there were eight producing zones on the oil properties of the Dominguez Estate Company, did you not?

Mr. Melville: I object, your Honor. He hasn't made it definite when this was.

Mr. Mackay: This is merely preliminary. At the basic date here, June 5, 1941.

The Witness: There were eight zones productive on a part of the lands of the Dominguez Estate Company, not upon all of the lands of the Dominguez Estate Company.

By Mr. Mackay:

Q. What was the lowest, what was the depth of the [844] lowest in these zones.

A. The lowest well?

Q. Yes, if you remember.

A. I think you mean the deepest one.

Q. I should say the deepest well.

A. There had been drilling on the land of the Dominguez Estate Company to a depth of 10,000 feet prior to June 5, 1941.

Q. How many wells had they—I will put it this

(Testimony of John H. Wents, Jr.)

way, had there been wells drilled prior to June 5, 1941, below either one of the eight zones?

A. Yes, there had.

Q. How many wells?

A. On Dominguez Hill as a whole, there were at least 11 wells that had been drilled into the eighth zone, the lower part of the eighth zone or to deeper horizons than the eighth zone as of June 5, 1941. I have not counted them up with respect to the Reyes lease or the Manuel lease or the Selbar lease, but this is with respect to deep drillings on Dominguez Hill.

Q. And how deep do those wells run?

A. The deepest well that had been drilled, that is, the deepest well stratographically that had been drilled was Callender No. 79, which was drilled to a depth of 12,720 feet, I believe.

The Court: Do you remember when that was drilled? [845]

The Witness: That Callender 79 was spudded, that is, drilling commenced as of September 16, 1940, and drilling had been finished by April 21, 1941.

By Mr. Mackay:

Q. With what result?

A. The well, as I said, was drilled to a total depth of 12,720 feet, or approximately 12,700 feet. The well went right down to the formation where the schist was identified in the well. Subsequent efforts to get flow resulted in the well being plugged

(Testimony of John H. Wents, Jr.)

back to 7,490 feet where it was producing from the 7000 and 8000 foot zones combined.

Q. Now, were there any other wells drilled at that date or prior to that date as deep or approximately deep as that No. 79?

A. Well, the Callender No. 15.

Q. Will you mark that on this map?

A. I have marked these well locations.

The Court: You say you have or you have not?

The Witness: I have marked them, your Honor. There is a mark on the special map here, and I think I can point out their respective locations.

The Court: Let me ask you, counsel, the purpose of this additional examination and identification?

Mr. Mackay: Well, I think this is quite important.

The Court: As I recollect—of course, I have been [846] off of this case for a week or so, but as I recollect it you gentlemen have stipulated as to the developments which had taken place on these leases prior to the basic date, and you had also stipulated the probable estimated production from the old field, both in barrels and in dollars. Now, I think the evidence has shown that these wells going down to or below the schist indicated that there had been complete exploration. At least, you gentlemen had agreed upon a probable estimate both for barrels and for money. Now, what purpose is there in going into more detail?

Mr. Mackay: If your Honor please, it is just

(Testimony of John H. Wents, Jr.)

this, and I can see where the Court is a little confused. In one of these many reports to the stockholders there was a statement made to the stockholders that somebody in the Shell Oil Company perhaps had some idea that there were deeper sands in the deeper zones, and I am just offering this in rebuttal of that.

Mr. Melville: Well, your Honor——

Mr. Mackay: In other words, it will only take a few minutes for me to outline the whole procedure. If your Honor please, Mr. Wents is prepared to and if permitted will testify that there were a number of wells drilled prior to the basic date at deeper zones, and that he was of the opinion at that time that there were no productive sands below those zones. He will also, if permitted to testify and show on the map, and there were three wells drilled subsequent to that time, and [847] that I will offer merely for the purpose of trying to confirm his opinion that on that date the lower zones were not productive.

The Court: Well, I have no desire to interfere with the way you try your case. I am just trying to get myself oriented here.

Mr. Mackay: I think that is quite right. I should have explained the purpose for going into this. It will only take a very few minutes.

Mr. Melville: Your Honor, the important thing, as I see it, is to put everyone's mind that has to do with this case, in the way of expert witnesses, I believe, back to June 5, 1941, and look at the pic-

(Testimony of John H. Wents, Jr.)

ture as they at that time saw it or could possibly have seen it. Now, the report of the president of the Dominguez Estate Company to his stockholders, made just shortly prior to that basic date, reveals the facts just as accurately as he could at that time. Now, true, his opinion may have changed since then because of developments subsequent to June 5, 1941, but I do not think such developments subsequent to our basic date have any bearing or relevancy in this case, and I am going to oppose right along any question or any exhibits which would bring into this picture something which was not in the picture on June 5, 1941.

Mr. Mackay: If your Honor please, I want to make myself very clear. The evidence will show that 11 wells were [848] drilled to deeper zones, and that they were dry holes as of that date. We certainly are clearly entitled to show that, particularly in view of the reports which counsel got in over my objection. Now, I am showing that wells were drilled, for no other purpose than as a confirmation—as the Supreme Court has said, you cannot close the book, you can look beyond the basic date for some purposes. The Court set the rule, I think, in the Ford case with Mr. Consens, where they said that you would have to refer to the basic date, but perhaps you could look beyond it a little. It seems to me this is one case where certainly we should be permitted to show the picture at the basic date.

Mr. Melville: It is not your desire, I am sure,

(Testimony of John H. Wents, Jr.)

to in any way change or effect or color or discolor the stipulated facts in the case?

Mr. Mackay: Not at all, but there is some evidence here, if your Honor please, that somebody thought and it went out in a report to the stockholders that there may have been some deeper zones. I want to prove what the situation was, and I should have that right.

Mr. Melville: All you are proving, then, Mr. Mackay, is that the corporation or the president of the corporation may or may not have thought wrong in April, May or June, of 1941. That is not important.

Mr. Mackay: I think it would be important.

The Court: I guess we are off on a tangent on account of my asking you what I did ask you. Proceed with the examination of the witness and I will rule on any objections.

By Mr. Mackay:

Q. Will you please tell the Court how many wells were drilled prior to June 5, 1941, to a zone deeper than the eighth zone, and will you please give the number? A. 11 wells.

Q. Will you give the numbers of those wells on this map?

A. Yes, with respect to the map which is in evidence and the same numbers prevail.

The Court: Why not put it on this map, then, which is part of the stipulation already? Why put in another map which is the same as the map you have in? It could be indicated on that.

(Testimony of John H. Wents, Jr.)

Mr. Mackay: That could be very easily done. We would have him draw a red line around the circle with a pencil.

The Court: Well, then, we will hand the witness Joint Exhibit 17-Q. Is counsel for the Respondent agreeable to letting the witness indicate on Joint Exhibit 17-Q the well or wells to which he desires to make reference?

Mr. Melville: If they are wells that were drilled prior to June 5, 1941. [850]

The Witness: Yes.

Mr. Melville: No objection.

The Court: Very well. You may indicate it on this map. Can you use it here?

The Witness: Yes, sir, this is Callender 79.

The Court: He has indicated on—what is that—the Reyes lease?

The Witness: No, this is the Union Oil Callender lease, Callender well No. 79. Then on the Union Oil Company Callender lease, Callender well No. 50, then on the Republic Petroleum Company Childs lease, Childs No. 3. Then on the Shell Oil Company, upon the Manuel lease of the Shell Oil Company, Manuel well No. 7. Then on the Selbar Stabler lease, Morton & Elder, well No. 1. Then on the Reyes lease, Reyes No. 90. Then on the Shell Oil Company Reyes lease, well No. 95. Then on the Reyes lease, well No. 97, Shell Oil Company. Then well No. 100 on the Shell Reyes lease. Then well 109 on the Shell Reyes lease. Drilling on well No.

(Testimony of John H. Wents, Jr.)

110, Shell Oil Reyes, 110 had been commenced but the well had not been completed.

The Court: You have indicated on the map the completed wells, is that right, Mr. Wents?

The Witness: Upon which drilling had been completed on or before June 5.

The Court: For the sake of the record I wish to [851] state that the Court has indicated by a circle with a number in it on the map just above the circle drawn by the witness the numbers which coincide to his testimony, namely, 1, 2, 3 and so forth through No. 10, so that the figures appearing on this exhibit are in the handwriting of the Court rather than of the witness and are put there for the purpose of identifying the marks put by the witness.

Mr. Mackay: Yes, that is agreed.

By Mr. Mackay:

Q. Now, how many wells were drilled since that time?

Mr. Melville: I object, your Honor, on the ground that anything subsequent to the basic date of June 5, 1941, could not possibly influence anyone's opinion if they were honestly putting themselves back to our basic date.

Mr. Mackay: I submit——

The Court: The objection will be overruled. He may answer how many wells were drilled since.

The Witness: At least six.

By Mr. Mackay:

Q. And with what result?

(Testimony of John H. Wents, Jr.)

A. None of them proved to be productive in zones lower than the eighth zone. No wells proved to be productive in zones below the eighth zone.

Q. Did I understand you to say that none of the 11 wells drilled prior thereto proved productive?

A. In the instances of the 11 wells that I mentioned at first, a good number of those wells were completed as successful producers, but were plugged from their biggest—lowest depth.

Q. Yes, that is what I mean.

A. By plugging them back, we were able to successfully complete the wells in a zone higher than that sought.

Q. I see.

Mr. Mackay: That is all.

Cross Examination

By Mr. Melville:

Q. Prior to June 5, 1941, how many wells in the Dominguez field had been drilled to the schist?

A. One well.

Q. Isn't it true, Mr. Wents, that in the Torrance field two wells had been drilled to the schist before 1928?

A. I would say there were probably more than two in the Torrance field drilled to the schist before 1928.

Q. Subsequent to 1928, they found oil in the Torrance field in spite of the fact that they had previously drilled to the schist, is that true?

(Testimony of John H. Wents, Jr.)

A. The Torrance field was discovered and was drilled up to a high degree prior to 1928.

Q. But, Mr. Wents, subsequent to drilling to the schist in the Torrance field, didn't they successfully [853] penetrate to deeper sands in other parts of the field and find oil? A. Yes.

The Court: I am sorry to interrupt you, but I desire to make a telephone call. We will take a brief recess. Excuse me, Colonel.

(A short recess was taken.)

The Court: You may proceed.

By Mr. Melville:

Q. Mr. Wents, there was a well brought in on our basic date, June 5, 1941, a successful well, was there not?

A. I don't know. You would have to refresh my memory with respect to that specific well. I can check very easily, but I don't remember the completion dates on each of the 140 wells on the Reyes lease.

Q. During the conference that we have had in this case preparatory to the trial, haven't we discussed the very significant or unusual fact that on that very day, June 5, 1941, a well was brought in?

A. I don't remember it.

Mr. Mackay: Will you mention the well?

The Witness: If you will mention the well, I can check. If it is a deep well I can check exactly on the completion date.

(Testimony of John H. Wents, Jr.)

By Mr. Melville: [854]

Q. I am not sure whether it was in the Torrence field or on the Reyes lease.

A. Well, we only have about 400 wells that I look after. I am sure I couldn't answer, unless you could name the specific well, then I might remember it.

Q. I don't want to take up the time of the Court to have you go through your records and refresh your memory. I ask you, however, if during 1941 there were not about 20 wells brought in in the Reyes lease?

A. Producing from upper zones.

Q. And you have already testified, I believe, that the fact that you drilled to the schist in one part of the field does not preclude you from drilling in another part of the field and getting oil even at a deeper level.

A. My testimony was not to that effect, and that is not in my own mind. I did not make that statement.

Q. Mr. Wentz, is the schist flat like this table?

A. No, it is not.

Q. Isn't it rolling or perhaps similar to mountains?

A. Undulating, it might be.

Q. What? A. Undulating.

Q. So the mere fact that you would strike the schist if you drilled here in a field does not have any bearing whatsoever on whether you might bring

(Testimony of John H. Wents, Jr.)

in a perfectly good well if [855] you drilled to the same depth over here, does it?

A. It may or it may not.

Q. That is the reason why you drilled 11 wells to the schist, because there was that possibility?

A. I did not testify that 11 wells had been drilled.

Q. I am sorry, I cannot hear you.

A. I did not testify 11 wells were drilled to the schist. I said 11 wells were drilled in the eighth zone or deeper.

Q. Let's talk about the 11 wells. What developed after you drilled the 11 wells?

A. I don't understand the question.

Q. What was the result of those 11 wells that were drilled that you testified about?

A. Of the 11 wells which were drilled, approximately 10 of them were successfully completed by plugging back into either the upper part of the eighth zone or into the seventh, sixth, fifth or the fourth zones, each of those zones occurring successively higher in the column.

Q. Did all the 11 go to the schist?

A. No, I didn't testify that all 11 went to the schist.

Q. How many of these 11 wells went to the schist?

A. One of those 11 wells went to the schist. However, there are other factors which govern.

Q. You have answered my question. [856]

Mr. Mackay: I think he can explain it, your Honor.

The Witness: Non-productivity of a deeper sand

(Testimony of John H. Wents, Jr.)

or the deeper sands having permeabilities and porosity—there might be oil saturations, but with very low permeabilities. We found that took place in excess of 8000 feet of the Dominguez Hill. We have not been able to complete wells successfully. We have certain wells that are as completed as low, I think, as 8400 feet, but our production from these wells is of a magnitude that it is uneconomic to drill them.

By Mr. Melville:

Q. Were the wells in the Dominguez Hill and more specifically the wells in the Reyes lease under curtailment during 1941?

A. Certain of the wells on the Reyes lease were under curtailment during 1941 for the entire period, that is, from, say, January 1st, 1941, to June 5th. Others of them, however, produced at or near their capacity.

Q. Those that were curtailed, will you please state the amount that was permitted under the curtailment?

A. I do not have the records available. However, in our stipulation, the stipulation was related to the effect of capacity productions.

Q. Isn't it a fact, Mr. Wents, that any time a well is under curtailment, the barrels per day method of appraising the value of the oil royalties is a felonious or very [857] inaccurate method?

Mr. Mackay: I object to that, if your Honor please, as not proper cross examination. I never went into that.

(Testimony of John H. Wents, Jr.)

The Court: Overruled. He may answer.

The Witness: The barrel per day method of appraising oil royalties is, in my estimation, one of the means of checking, because commonly in the purchase of an oil royalty or appraisal of an oil royalty all you are dealing with is barrels of oil for future delivery, and when those barrels have been arrived at, then it is the reduction of your barrels to dollars and the dollars by deferment, and so forth. As far as checking the accuracy of an appraisal, if you are dealing with curtailment of a magnitude that is almost equal to the spot supply, you know that there are certain limits to which you could go or certain appraisal limits to which you could go to reduce the royalty and be safe and not spend your money foolishly. That is the purpose of using that means. It is just a check.

Q. Do I understand your answer to be that the barrels per day method is erroneous or a poor measure when you are dealing with a well that is under curtailment?

Mr. Mackay: I submit, if you Honor please, the question and the answer must stand.

Mr. Melville: As I listened to his answer, I didn't understand the way he was answering my question.

Mr. Mackay: If your Honor please, he asked him about felonious in the first place, and I think the question has been answered.

Mr. Melville: I am sure it has not.

The Court: I rather thought that it had, but

(Testimony of John H. Wents, Jr.)

we will permit him to answer it again, if counsel thinks it was not answered.

The Witness: In speaking of an individual well, I would say if it was curtailed completely to zero that the barrel per day method would be a very poor method of appraising that particular well.

By Mr. Melville:

Q. How about if it was curtailed 50 per cent?

A. If curtailed to 50 per cent, then the figure that would be used by the adoption of the adoption of the barrel per day method of appraisal would be a higher figure than you could justify using if it was producing wide open. So is is a case of judgment on the part of the appraiser as to how he can use a series of figures.

Q. Yes. I understand your testimony to be that if an appraiser is going to use the barrel per day method as a means of appraising the value of oil royalties, he must necessarily know the percentage of curtailment, isn't that right?

A. Yes, that is right.

Mr. Melville: No more questions. [859]

Mr. Mackay: That is all.

The Court: Stand aside, Mr. Wents.

(Witness excused.)

Mr. Mackay: That is all, your Honor. The Petitioner rests.

Mr. Melville: The Respondent rests.

The Court: That completes the trial of these cases, does it?

Mr. Mackay: Yes, your Honor. We are very happy to bring it to a termination.

The Court: Off the record.

(Discussion off the record.)

The Court: On the record.

I take it you gentlemen will desire to file briefs.

Mr. Mackay: Yes, your Honor.

The Court: I will allow you a little extra time because we have a long record.

Mr. Mackay: If your Honor please, I would suggest—I would like to ask a longer time. We are very busy, and we do not get our transcripts for at least 20 days and sometimes a little longer, so I would think that 75 days ought to be allowed us for that purpose, for the Petitioners' brief.

The Court: I will allow you that.

Mr. Melville: I would like to have the reply brief within 50 days thereafter, your Honor. [860]

The Court: Well, let's make it 45 or 60. Which would you rather have?

Mr. Melville: I will take the 60 and try to get in in 45.

The Court: Very well. The schedule then will be, Petitioner will have 75 days from this date within which to file the opening brief, then Respondent will have 60 days within which to file the answer brief, and the Petitioner will have 30 days within which

to file reply brief, and the proceeding will stand submitted on that basis. Thank you, gentlemen.

(Thereupon, at 5:10 p. m., October 19, 1945, the hearing in the above-entitled matter was closed.)

Filed Nov. 13, 1945. [861]

The Tax Court of the United States
Docket No. 2257

VICTORIA L. COTTON,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 7583.

VIRGINIA CALDWELL,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

STIPULATION

It is hereby stipulated and agreed by and between the parties hereto, through their respective counsel, as follows:

(1) That the above entitled proceeding may be,

and they hereby are, consolidated for hearing, consideration and opinion;

(2) That the oral and documentary evidence and stipulations of facts received in the case of Victoria L. Cotton, Docket No. 2257, shall be deemed to have been received in the case of Virginia Caldwell, Docket No. 7583;

(3) That for the purposes of this proceeding any reference to the date of June 5, 1941, and any valuations as of that date shall be applicable, without change, to the date August 11, 1941, and that the [862] fair market value of any assets stipulated or determined by the Court as of June 5, 1941, shall be deemed to be the fair market value thereof as of August 11, 1941.

/s/ A. CALDER MACKAY,
/s/ ARTHUR McGREGOR,
/s/ HOWARD W. REYNOLDS,
/s/ ADAM Y. BENNION,
Counsel for Petitioner.

/s/ J. P. WENCHEL, RHN,
Chief Counsel Bureau of
Internal Revenue.
Counsel for Respondent.

Filed Oct. 8, 1945. [863]

United States Circuit Court of Appeals for the
Ninth Circuit

Tax Court Docket No. 2257

VICTORIA L. COTTON,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR REVIEW OF DECISION OF
THE TAX COURT OF THE UNITED
STATES

To the Honorable Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

Comes now Victoria L. Cotton, petitioner herein, and respectfully shows:

I.

Nature of the Controversy

Respondent determined a deficiency in gift taxes against petitioner for the calendar year 1941 in the sum of \$7,845.75. This deficiency arose because the respondent had increased the value of the gift.

Petitioner filed an appeal with The Tax Court of the United States, which appeal was consolidated for trial and opinion with the appeal of Virginia Caldwell, a related case involving a deficiency in gift tax of \$18,645.51 for the year 1941.

The cases were tried at Los Angeles, California, during the week of October 8, 1945, before the Hon-

orable Arthur J. Mellott, Judge [864] of the Tax Court of the United States. Thereafter, and on December 8, 1945, Judge Mellott resigned, and the Honorable Byron B. Harlan thereafter was appointed Judge of the Tax Court of the United States and was assigned this case.

Under date of July 22, 1946, The Tax Court of the United States promulgated its Memorandum Findings of Fact and Opinion, whereupon, on the 19th day of August, 1946, petitioner filed with The Tax Court of the United States a Motion for Rehearing, the grounds therefor being principally that the Judge (Judge Mellott) who heard the evidence took no part in deciding the case.

As an alternative to this motion, petitioner filed a Motion for Reconsideration. As an alternative to the two foregoing motions, petitioner filed a Motion for Review of Report by the Full Court.

These motions were denied, the first two on the 20th day of August, 1946, and the third on the 21st day of August, 1946. Thereafter and on November 12, 1946, The Tax Court of the United States entered its decision that there was a deficiency in gift tax due from petitioner for the year 1941 in the sum of \$5,214.00.

The controversy involves a determination of the fair market value on June 5, 1941, of 200 shares of the capital stock of Carson Estate Company which petitioner on that date gave to her children. In her gift tax return for 1941 petitioner placed

a value on said stock of \$250.00 per share, or \$50,000.00 for the 200 shares. The respondent in his notice of deficiency valued said stock at \$600.00 per share, or \$120,000.00 for the 200 shares.

The 200 shares of stock of Carson Estate Company given away by petitioner represented 2.7 per cent of the total outstanding stock of that company. [865] The Carson Estate Company owned stocks, bonds, real estate, and some oil properties. Among the stocks it owned were 1,785 shares of the Francis Land Company, which in turn owned approximately 52.4% of the outstanding stock of the Dominguez Estate Company. The Dominguez Estate Company was an operating company owning substantial lands located in the County of Los Angeles, State of California, part of which were oil producing. These oil producing lands had been leased to the Shell Oil Company, the Union Oil Company, and other important producers.

In compliance with the rule of The Tax Court of the United States that facts be stipulated to the fullest extent, the parties agreed by stipulation as to the fair market value of all the underlying assets of the Carson Estate Company and the Dominguez Estate Company except the oil properties of the Dominguez Estate Company. The oil properties owned by the Carson Estate Company were rather insignificant. However, the oil properties of the Dominguez Estate Company were very substantial and it was the value of these oil properties which was the principal subject of controversy.

In order to shorten the time of the trial the parties entered into a stipulation agreeing to the estimated probable future production (in barrels) and the estimated royalty shares (in barrels) of Dominguez Estate Company, and also agreeing to the estimated probable future royalty income. Petitioner presented the expert testimony of two witnesses regarding the value of the oil royalties, and their opinions were \$2,701,361.00 and \$3,000,000.00 respectively. Respondent presented the expert testimony of five witnesses on this question, two of whom expressed an opinion of \$4,000,000.00, one \$4,330,255.00, one \$4,460,000.00, and the other did not express an opinion in dollars and cents. [866]

Judge Harlan, who did not hear the witnesses, found as a fact and determined that the value of the oil properties of the Dominguez Estate Company on June 5, 1941, amounted to \$4,500,000.00. In so doing he assumed that a witness called by petitioner on the question of the valuation of the stocks (Mr. Eitner) had testified that the oil properties had a value of \$4,988,600.00, whereas said witness had not been asked to, nor did he, express an opinion with respect to the oil properties; and Judge Harlan also gave credence to the testimony of two other witnesses called by respondent (Mr. Phillips, \$4,934,391.00, and Mr. Grimes, \$4,819,070.00), who admittedly were not oil engineers and had no familiarity with the oil properties in question.

A value of \$4,500,000.00 for the oil properties,

when added to the stipulated value of the other assets owned by Dominguez Estate Company, resulted in total net assets, divided by the number of shares of stock outstanding, of \$902.91 per share. Judge Harlan found and determined that the value of the Dominguez Estate Company stock was \$900.00 per share.

Five expert witnesses called by petitioner and one expert witness called by respondent on the question of stock valuation testified that even the marketable securities of the most liquid companies were selling on June 5, 1941, at substantial discounts below the fair market value of their underlying assets. Petitioner's witnesses valued the stock of Dominguez Estate Company at from \$304.00 to \$420.00 per share; and said witness for the respondent valued the stock at \$759.00 per share.

Two other witnesses called by respondent admitted that they had valued the stock by dividing the number of shares outstanding into the value of the company's assets as determined by them. One expressed the opinion of \$861.46 per share, although he testified that on an [867] earnings basis the stock would be valued at only \$709.05 per share; the other testified to a figure of \$933.31 per share.

The earnings of Dominguez Estate Company amounted to approximately \$48.00 per share during 1940 and 1941; and uncontradicted evidence, based upon the stipulation of probable future oil income, was presented by petitioner that the earnings for

the succeeding ten-year period, after depletion, would not exceed \$30.00 per share. Witnesses for both parties testified that the stocks of the very best companies and of comparable companies were selling at from seven to ten times earnings.

A value of \$900.00 per share for the stock of Dominguez Estate Company is equivalent to 20 times its current earnings and 30 times its expected earnings over the succeeding ten years.

Judge Harlan reflected the determined value of \$900.00 per share for the stock of Dominguez Estate Company upon the balance sheet of Francis Land Company, which resulted in a net asset value for the Francis Land Company stock of \$989.40 per share. Judge Harlan found and determined that the fair market value of the stock of Francis Land Company was \$990.00 per share on June 5, 1941. He followed the same procedure with respect to the Carson Estate Company stock, finding a value thereof in the amount of \$500.00 per share.

Petitioner avers that in the record and proceedings before The Tax Court of the United States, in the denial of petitioner's motions and in the opinion and decision rendered by The Tax Court of the United States manifest error occurred and intervened to the prejudice of petitioner, who now assigns the following points on which petitioner intends to rely in this proceeding:

The Tax Court of the United States erred: [868]

(A) In determining and deciding without any

evidence or substantial evidence in support thereof a value of \$900.00 per share for the stock of Dominguez Estate Company.

(B) In determining and deciding without any evidence or substantial evidence in support thereof a value of \$990.00 per share for the stock of Francis Land Company.

(C) In determining and deciding without any evidence or substantial evidence in support thereof a value of \$500.00 per share for the stock of Carson Estate Company.

(D) In denying petitioner's Motion for Rehearing.

(E) In denying petitioner's Motion for Reconsideration.

(F) In denying petitioner's Motion of Review of Report by the Full Court.

(G) In finding and deciding that Dominguez Estate Company was a holding company.

(H) In finding and deciding that Dominguez Estate Company was not an operating company.

(I) In failing to find and decide that Dominguez Estate Company was an operating company.

(J) In finding and deciding without any evidence or substantial evidence in support thereof that the fair market value of the oil properties of Dominguez Estate Company was \$4,500,000.00.

(K) In failing to take into consideration the fact that the oil properties of Dominguez Estate

Company sought to be valued were of a speculative nature necessitating the consideration of speculative matters, and in failing to take into consideration all elements and factors, speculative and otherwise, that affect such value. [869]

(L) When determining the fair market value of the oil properties of Dominguez Estate Company, in failing to take into consideration:

(1) Comparative sales of oil royalties.

(2) Established and approved methods of determining such values.

(3) The known and future income tax burdens on the estimated probable future income from said oil properties.

(4) Every element, physical or otherwise, which will reflect on the income emanating from the operation or production of the oil properties.

(5) The opinion of qualified and experienced witnesses.

(6) The stipulated facts and documents and evidence contained in the record.

(M) In determining the fair market value of the oil properties of Dominguez Estate Company to erroneously assume, contrary to the facts set forth in the stipulation and record, that the "computation of the estimated probable future income from the oil properties" was a fixed, certain amount to be received.

(N) When determining the fair market value of the oil properties of Dominguez Estate Company, in giving credence to the opinions expressed by witnesses Grimes and Phillips, who are not oil engineers and who were not familiar with the oil properties and whose value was based in the one case, upon an erroneous formula derived merely from stock market quotations of a date more than five months prior to the date of the gift, and in the other, upon a misapplication of a formula prepared by some one else and without having been informed as to the estimated probable future production in barrels. [670]

(O) When determining the fair market value of the oil properties of Dominguez Estate Company, in accepting the values given by witnesses Grimes and Phillips, whose testimony was substantially repudiated by four other witnesses called by the respondent.

(P) When determining the fair market value of the oil properties of Dominguez Estate Company, in assuming that witness Eitner gave an opinion as to the fair market value of said oil properties.

(Q) When determining the fair market value of the stock of the Dominguez Estate Company, in failing to take into consideration:

- (1) The company's net worth.
- (2) The company's earning power.
- (3) The company's dividend-paying capacity.

(4) The effect upon the value of said stock of income tax burdens.

(5) The relative values, in relation to assets and earnings, of listed stocks as required by section 811(k) of the Internal Revenue Code.

(6) The then depressed economic conditions.

(7) All other relevant factors having a bearing upon the said stock as required by respondent's regulations and established court decisions.

(R) In assuming that the fair market value of the stock of Dominguez Estate Company was a sum equivalent to the value of its net assets divided by the number of its outstanding shares, and in giving credence to the testimony of experts who admitted that their values were obtained by dividing the assets by the number of shares outstanding.

(S) In failing to give proper discount for the fact that [871] petitioner's 200 shares of the stock of Carson Estate Company, the subject of the gift, were a minority interest unable to force a liquidation.

(T) In considering transfers of the stocks in question between members of the families where the stipulated facts showed that such transfers were too far removed from June 5, 1941, to have any relevancy or materiality in a determination of value as of that date, and were not bona fide, arms-length transactions having any relevancy to the question of fair market value.

II.

The Court in Which Review is Sought

The United States Circuit Court of Appeals for the Ninth Circuit is the Court in which review of said decision of The Tax Court of the United States is sought pursuant to the provisions of Section 1141 of the Internal Revenue Code.

III.

Venue

The denials of petitioner's motions for rehearing and reconsideration were entered on August 20, 1946, and the denial of petitioner's motion for review by the full Tax Court of the United States was entered on August 21, 1946. The final decision determining a deficiency was entered on November 12, 1946.

For many years last past petitioner has resided and does now reside in the County of Orange, State of California. She filed her Federal gift tax return for the year 1941 with the United States Collector of Internal Revenue for the Sixth District of California, whose office is located at Los Angeles, California, and within the Ninth Judicial Circuit of the United States. [872]

The parties hereto have not stipulated that said decision may be reviewed by any Court of Appeals other than the one herein designated.

Wherefore, petitioner prays that the denial of

petitioner's motions and the decision of The Tax Court of the United States herein be reviewed by the United States Circuit Court of Appeals for the Ninth Circuit; that a transcript of the record be prepared in accordance with the law and rules of said Court and transmitted to the Clerk of said Court for filing; and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected by said Court.

Dated November 13th, 1946.

/s/ A. CALDER MACKAY,
/s/ ARTHUR McGREGOR,
/s/ HOWARD W. REYNOLDS,
/s/ ADAM Y. BENNION,
Counsel for Petitioner.

Filed Nov. 18, 1946. [873]

[Title of Circuit Court of Appeals and Cause.]

NOTICE OF FILING PETITION
FOR REVIEW

To John P. Wenchel, Chief Counsel,
Bureau of Internal Revenue,
Washington, D. C.

You are hereby notified that the petitioner on the day of November, 1946, filed with the Clerk of The Tax Court of the United States at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision of The Tax Court of the United States heretofore rendered in the above-entitled cause, and of its denial of petitioner's motions for rehearing, reconsidering and review by the full Court. A copy of the petition for review as filed is hereto attached and served upon you.

Dated this 18th day of November, 1946.

/s/ A. CALDER MACKAY,
/s/ ARTHUR McGREGOR,
/s/ HOWARD W. REYNOLDS,
/s/ ADAM Y. BENNION,
Counsel for Petitioner. [874]

Personal service of the foregoing notice, together with a copy of the petition for review, is hereby acknowledged this 18th day of November, 1946.

/s/ J. P. WENCHEL, C.A.R.
Bureau of Internal Revenue
Counsel for Respondent.

Filed Nov. 18, 1946. [875]

The Tax Court of the United States
Tax Court Docket

No. 2257

VICTORIA L. COTTON,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE

MOTION FOR ORDER DIRECTING TRANS-
MISSION OF EXHIBITS IN ORIGINAL
FORM

Whereas, the petitioner above named has heretofore filed a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision entered herein by The Tax Court of the United States; and

Whereas, the petitioner intends to designate for inclusion in the record on review in this cause the following:

Stipulation of facts filed on October 8, 1945, with Joint Exhibits 1-A to 20-T, inclusive, attached thereto;

Stipulation filed on October 19, 1945, with Exhibits 1, 2, and 3 attached thereto;

Petitioner's exhibits 21 to 31, inclusive, filed at the hearing; and

Respondent's exhibits AA to MM-2, inclusive, (except exhibits EE and FF), filed at the hearing;

and

Whereas, the petitioner alleges that, in the interest of economy and for other reasons, the stipulations and exhibits hereinabove referred to should be transmitted to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit in their original form, and that an order of this Honorable Court should be entered to that end in conformity with Rule 75 (i) of the Federal Rules of Civil Procedure; [876]

Now, Therefore, petitioner, by and through her counsel, respectfully moves that an order be entered by this Honorable Court directing that the stipulations and exhibits set forth hereinabove be transmitted to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit in their original form with the record on review in this cause and containing such further orders regarding the safekeeping, transportation and return thereof as shall be deemed proper.

Dated December . . , 1946.

/s/ A. CALDER MACKAY,
/s/ ARTHUR MCGREGOR,
/s/ HOWARD W. REYNOLDS,
/s/ ADAM Y. BENNION,
Counsel for Petitioner.

Filed Dec. 5, 1946. [877]

[Title of Tax Court and Cause.]

ORDER RE TRANSMISSION OF DOCUMENTS IN ORIGINAL FORM

Upon consideration of the motion filed by petitioner in the above case for transmission of original documents to the United States Circuit Court of Appeals for the Ninth Circuit, it is

Ordered, that the duplicate original of the stipulation of facts filed October 8, 1945 with joint original exhibits 1-A to 20-T attached thereto; duplicate original of stipulation filed October 19, 1945 with original exhibits 1, 2, and 3 attached thereto; petitioner's exhibits 21 to 31, inclusive and respondent's exhibits AA to MM-2, inclusive (except exhibits EE and FF) be transmitted by the Tax Court of the United States to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit as physical documents in lieu of reproduction of copies in the certified record on review.

/s/ BYRON B. HARLAN,
Judge.

Dated: Washington, D. C., December 9, 1946.

[Title of Tax Court and Cause.]

PETITIONER'S DESIGNATION OF CON-
TENTS OF RECORD ON REVIEW

To the Clerk of The Tax Court of the United States:

The petitioner hereby designates for inclusion in the record on review in the above entitled proceeding the following:

The complete record of all the proceedings and evidence taken before The Tax Court of the United States and all matters required by Subdivision (g) of Rule 75 of the Federal Rules of Civil Procedure, including the following:

1. Docket entries of all proceedings before The Tax Court.
2. Pleadings before The Tax Court,
 - a. Petition, including annexed copy of deficiency letter.
 - b. Answer.
3. The Memorandum Findings of Fact and Opinion of The Tax Court.
4. Motion for Rehearing and denial thereof.
5. Motion for Reconsideration and denial thereof.
6. Motion for Review by Full Court.
7. Order dated August 21, 1946, denying Motion for Review by Full Court.

8. The decision of The Tax Court. [879]
9. The official transcript of oral testimony, pages 1 to 765, inclusive.
10. Stipulation of consolidation, etc., filed on October 8, 1945.
11. Stipulation of Facts filed on October 8, 1945, with Joint Exhibits 1-A to 20-T, inclusive, attached thereto.
12. Stipulation filed on October 19, 1945, with Exhibits 1, 2 and 3 attached thereto.
13. Petitioner's Exhibits 21 to 31, inclusive, filed at the hearing.
14. Respondent's Exhibits AA to MM-2, inclusive (except Exhibits EE and FF), filed at the hearing.
15. The Petition for Review by the United States Circuit Court of Appeals for the Ninth Circuit.
16. Notice of Filing of Petition for Review, together with proof of service thereof and of service of a copy of the Petition for Review.
17. Motion and order directing the transmission in their original form of items 11 to 14 above, inclusive.
18. This designation of contents of record on review.

Dated December . . , 1946.

/s/ A. CALDER MACKAY,
/s/ ARTHUR McGREGOR,
/s/ HOWARD W. REYNOLDS,
/s/ ADAM Y. BENNION,

Counsel for Petitioner. [880]

ACKNOWLEDGEMENT OF SERVICE

Personal service of a copy of the foregoing designation is hereby acknowledged as having been made this 5th day of December, 1946.

/s/ J. P. WENCHEL, SLV
Chief Counsel, Bureau of Internal Revenue, Counsel for Respondent.

Filed Dec. 5, 1946. [881]

[Title of Tax Court and Cause.]

CERTIFICATE

I, Victor S. Mersch, clerk of The Tax Court of the United States do hereby certify that the foregoing pages, 1 to 881, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand

and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 13th day of December, 1946.

[Seal] /s/ VISTOR S. MERCH, EMT
Clerk.

[Endorsed]: No. 11506. United States Circuit Court of Appeals for the Ninth Circuit. Victoria L. Cotton, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petition to Review a Decision of The Tax Court of the United States.

Filed December 19, 1946.

 /s/ PAUL P. O'BRIEN,
Clerk of the United States Circuit Court of Appeals
for the Ninth Circuit.

